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ROYALTY MANAGEMENT PROGRAM

HEARING

BEFORE THE

SUBCOMMITTEE ON MINERAL RESOURCES
DEVELOPMENT AND PRODUCTION

OF THE

COMMITTEE ON
ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON THE

DEPARTMENT OF THE INTERIOR'S ROYALTY MANAGEMENT PROGRAM

MAY 23, 1988

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ROYALTY MANAGEMENT PROGRAM

MONDAY MAY 23, 1988

U.S. Senate,
Subcommittee on Mineral Resources
Development and Production,
Committee on Energy and Natural Resources,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:08 a.m. in room SD-366, Dirksen Senate Office Building, Hon. John Melcher, presiding.

OPENING STATEMENT OF HON. JOHN MELCHER, U.S. SENATOR FROM MONTANA

Senator Melcher. The subcommittee will come to order.

Today the Subcommittee on Mineral Resources Development and Production will receive testimony on the Department of the Interior's Royalty Management Program. This is the proper place to start a series of hearings that will extend through the summer on just what is going on on both Indian reservations and Federal lands where there are oil and gas wells. What is happening?

From 1979 to 1980 or 1981, we in the Congress were alarmed to discover that the reporting of oil and gas royalties from these lands seemed to be inaccurate.

Furthermore, we were alarmed that inspections, the basic work of determining what is going on in an oil field or gas field on either Indian or Federal land, were not properly done.

About midyear in 1981, Secretary Watt, responding to that concern, appointed the Linowes Commission, which over a period of six, eight, nine months, received testimony from a broad range of the people involved with oil and gas production on these lands and from a broad range of states and Indian tribes which had a series of complaints. The Linowes Commission made 60 recommendations to improve royalty management.

We asked David Linowes, who served as chairman of that commission, to come and testify today. Unfortunately, he was not able to do so. But we do have a letter from Professor Linowes who is busy out at the University of Illinois at Champagne-Urbana, and we will make that part of the record immediately following my remarks.

As a result of the Linowes Commission recommendations in 1982, Congress passed what is known as the Federal Oil and Gas Royalty Management Act. In that legislation, we required the Department of the Interior to establish a comprehensive inspection, collection, accounting and auditing system.

Unfortunately, progress in implementing those recommendations has been slow. To date, action by the Department falls far short of adequately carrying out the requirements of this law. Today, we are going to hear attempts to explain why that is the case.

Just last month the Interior Department's Inspector General concluded that the Minerals Management Service had not implemented adequate procedures to ensure the effective resolution of reported underpayments. MMS, according to the Inspector General's report, was not disbursing substantial royalties in a timely manner to the proper recipients and was not providing adequate audit coverage of mineral leases.

In addition, the report seems to pinpoint the very slow procedure of effective inspection of the leases. I do not know why that should be the case now. We were told by Watt and his successors that whatever it took for the Minerals Management Service, whatever it took for the Bureau of Land Management to provide both adequate and good inspection and adequate and good auditing would be made available both in funds and training and in priorities.

We have no evidence of theft, we are told by the Bureau of Land Management, by MMS and the Inspector General's reports. I hope that is everybody's view, including the owners, which in some cases would be Indian tribes, or the royalty sharers, which would be states.

Nevertheless, we do not find that what was outlined by both the Linowes Commission and by the action of Congress in this 1982 bill has been carried out. So I can tell you that this hearing and the hearings to follow will be cooperative, bipartisan efforts on behalf of this committee to work with all the Federal entities that are involved, the states that are involved, the tribes that are involved and the producing companies that are involved because it is to everyone's advantage to make sure that from the time when a well is first spudded until it goes into production that the process of inspection, accounting and auditing all take place properly.

So we will now turn to the witnesses. We have three witnesses today, and we are going to take them as a panel: James Richards, Inspector General, Department of the Interior; William Bettenberg, Director of Minerals Management Service; and Roland Robison, Deputy Director of Bureau of Land Management.

If all three of you would come forward to the witness table, we would like to have you give your testimony one after another and then to be available for questions.

Thank you very much for coming. We will hear first from James Richards, the Inspector General.

[The letter from Professor Linowes follows:]

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May 12, 1988

Senator John Melcher
Chairman, Committee on Energy and
Natural Resources
Washington, D.C. 20510-6150

Dear Senator Melcher:

Thank you for your letter of May 2, 1988 inviting me to testify before the Subcommittee on Mineral Resources Development and Production of the Energy and Natural Resources Committee at its hearing on May 23, 1988. Regretfully, I have another commitment on that same day, making it impossible for me to appear.

I did however look over the material sent to me by Ms. Patricia J. Beneke, Senior Counsel of your Committee, and compared it with the recommendations contained in the report of the Commission of Fiscal Accountability of the Nation's Energy Resources which I submitted to the President and the Congress on January 21, 1982.

It appears that although there has been some action since that time in implementing our recommendations, progress seems to have been quite slow. This is suprising as all of our recommendations were accepted by the Administration over six years ago when I presented the report to the Secretary of the Interior and the President. I especially note that internal control procedures still need attention.

In view of the foregoing, I thought it would be helpful for me to submit for the record a copy of our recommendations as contained in Chapter Nine, "Summary of Recommendations" of our report.

Sincerely,

Professor David F. Linowes

Enclosure

DFL/jcp

CHAPTER NINE

SUMMARY OF RECOMMENDATIONS

OF THE

Report of the Commission

Fiscal Accountability of the Nation's Energy Resources

January 1982

CHAPTER NINE

SUMMARY OF RECOMMENDATIONS

INTERNAL CONTROLS

Production Start-up Notification

1. That the Department require an operator to notify it by telegram or equivalent means on the first business day after new production begins on a lease. Failure to comply would subject the operator to a penalty equal to the value of the total production between the start of production and the date of notification, except in those rare cases when extenuating circumstances require an exception.(Page 48)

Payor Plan

2. That the Department immediately require all lessees of revenue producing leases or their agent (the operator or some other agent) to submit a payor plan signed by all payors indicating the payment responsibilities of each party. In the payor plan, the lessee should identify the payors for 100 percent of the royalty obligation. Modified payor plans must be submitted whenever any payor responsibilities change. Upon receiving such changes, the Federal royalty managers should

consider them as being proper unless they are later disapproved. Noncompliance with these requirements would subject the lessees to substantial penalties.(Page 51)

Lease Subaccounts

3. That the managers of the Federal royalty program complete in a timely fashion the installation of the new subaccount system in which each payor on a lease has an account, replacing the current system which features a statement of account by lease (but with multiple payors).(Page 54)

Operator of Record

4. That the Federal royalty managers work toward the implementation of the concept of an "operator of record" for each lease and, where possible, a single payor; the operator of record would be responsible for maintaining all records related to the payment of royalties from that lease.

   Each month after the payments are made, the operator of record would reconcile the payments with the production report, notify the Federal royalty managers of any discrepancies and the reasons for them, and provide the Federal royalty managers with the correct information. Where a single payor is possible, all payments for that lease would be made by one individual and all records kept by him. (Page 54)

Use of Production Records

5. That the Federal royalty managers incorporate production data into the royalty management system in order to cross check the data with sales and royalty data for all leases each payment period. This should begin immediately on a systematic sampling basis even though it will have to be done manually. (Page 62)

Verification of Production and Sales

6. That the Federal royalty managers periodically obtain well test data, run tickets, and LACT meter readings on a sample basis, or according to some other systematic plan, and use them to cross check production reports. This comparison would be in addition to that done as part of an audit program focused on leases with suspected irregularities. (Page 62)

Purchasers' Reports

7. That the Department seek legislation authorizing the Federal royalty managers to require that purchasers submit copies of their reports directly to the Federal royalty managers in a format prescribed by the royalty managers,

and to impose civil penalties in the event of noncompliance. This authority would be exercised at least in those cases where there is no other government-required report provided by a party different from the payor covering that particular oil, gas, or other mineral taken from the lease for the same reporting period; and

That the Federal royalty managers systematically check these purchaser reports against reports submitted by the payor, at least on a sample basis. (Page 62)

Channels of Commerce Study

8. That the Secretary request the Inspector General to lead a study of alternatives to purchasers' statements for the purpose of cross checking oil and gas sales in cases where there may be collusion between purchasers and sellers. The study should include an evaluation of the usefulness and legal complexities of tracing minerals through channels of commerce to processors or major end users, not just to first purchasers, as an ultimate cross check on production, sales, and royalty reports.(Page 63)

Meshing Inspection and Financial Management

9. That the Federal royalty managers incorporate in the new royalty management system data elements derived from field inspections, and that they establish criteria for irregularities identified by internal accounting and auditing procedures which should trigger an onsite review. (Page 63)

Product Valuation Guidance

10. That within five months after the filing of the Commission's report, Federal royalty managers decide what issues related to fair market value and other product value matters must be settled by the Department before more definitive guidance can be provided to the industry, and determine what issues can be settled by the royalty managers alone;

    That by January 1, 1983, the Federal royalty managers provide preliminary guidance to the industry on the issues identified for resolution without significant Departmental participation; and

    That by July 1, 1983, the Federal royalty managers issue detailed guidance to industry covering both sets of issues. (Page 67)

Late Payment Identification

11. That the Federal royalty managers, as soon as possible, incorporate into the royalty management system the automatic identification of late payments and institute a policy of immediate follow-up. (Page 69)

Offshore Refunds

12. That the Secretary urge the Congress to change the time-consuming process which the industry must go through to obtain refunds of royalty overpayments on offshore leases.(Page 69)

Interest Rates

13. That the Federal royalty managers continue charging at least the "current value of funds rate" established quarterly by the U.S. Treasury for late payments or underpayments. (Page 69)

60 Day Payment for Gas

14. That the Federal royalty managers allow 60 days for payment of royalties for natural gas after the end of the month in which the gas is used, sold, or removed from the lease. This policy would be consistent with present industry practice.(Page 69)

Accelerated Look-Back Audits

15. That the Department carry out the first 25 look-back audits on an accelerated schedule with completion no later than the end of calendar year 1983, and that audits of companies in addition to the first 25 be initiated as soon as possible, but no later than the end of calendar year 1983. (Page 73)

Look-Back Audit Plan

16. That the Department develop a definitive plan for choosing which companies should be the subject of both the first 25 look-back audits and subsequent ones. This plan should include provision for assuring adequate coverage of small companies and onshore leases, including Indian leases.(Page 73)

Account Reconciliation

17. That the managers of the Federal royalty program develop a definitive plan for choosing lease accounts for reconciliation. This should be based on a reasonable method for determining which accounts on leases (or groups of leases, such as in units) it would be most beneficial to pursue in detail. Because account balances are unreliable indicators, they should not serve as the sole basis for this selection. The plan should be developed and initial analyses begun without delay. Look-back audits should not be considered

an alternative to lease account reconciliations. (Page 73)

Routine Audit Program

18. That the Federal royalty managers adopt a program of increased systematic audits. In addition, provision should be made for audits triggered by flagged discrepancies between production reports and sales or royalty reports or by discrepancies discovered by inspectors in the field. (Page 75)

System Corrections

19. That the managers of the Federal royalty program institute a formal system by which the program's own audit findings and those of GAO and the Inspector General are systematically reviewed to identify weaknesses which can be corrected in the royalty management system. (Page 75)

Certified Public Accountants

20. That the Secretary consult with the American Institute of Certified Public Accountants to arrange for professional services by the companies' certified public accountants with respect to the adequacy of the internal controls and accounting for royalty payments, either through an extension of the CPA's regular auditing procedures or through separate engagements; and

That the Secretary consider including a requirement for such professional services in future leases and regulations. (Page 77)

Additional Staff

21. That the Secretary provide additional staff to the royalty management program in the accounting, auditing, and product valuation programs as soon as possible and protect the royalty management program from across the board budget cuts and personnel freezes for several years; to accomplish this, as early as possible, submit the 1982 budget supplemental as developed by the USGS with the full $5 million for look-back audits, and with other increases as necessary to carry out those Commission recommendations approved by the Secretary. (Page 79)

Comprehensive Training

22. That the Federal royalty managers immediately provide a comprehensive training program for their financial staff in oil and gas industry practices. (Page 79)

Performance Standards for Managers

23. That the Senior Executive Service and Merit Pay Standards for the royalty management system managers be revised

to include specific standards with deadlines which will hold the managers and supervisors accountable for the success or failure of the implementation of the new royalty management system, and for the implementation of those recommendations of this Commission approved by the Secretary.(Page 79)

SITE SECURITY

Departmental Policy

1. That the Secretary reaffirm by a letter to all lessees and lease operators that the Department holds them responsible for security on Federal and Indian lease sites and that the Department will conduct an active enforcement program to assure that their site security responsibilities are carried out in a satisfactory manner. (Page 91)

Site Security Plans

2. That all operators on Federal and Indian lands be required by regulation to develop lease site security plans detailing how that operator will carry out his responsibility to ensure security of the site. These plans would be required to be consistent with minimum government standards and would be submitted to the managers of the Federal royalty program. (Page 91)

Revised Regulations

3. That USGS regulatory requirements be revised to eliminate any detailed regulatory requirements for site security and require instead that operators take the necessary steps

to provide for site security as well as to meet minimum standards. Both requirements must be incorporated by operators into all site security plans. Deviations from these minimum requirements would be permitted on a case-by-case basis by the Federal royalty managers. Noncompliance with the principal requirements of the plan proposed and agreed to by the operator would be prima facie evidence of noncompliance with the Federal regulations. Noncompliance with the minimum requirements would also be a violation. Both violations would be subject to substantial penalties. (See Chapter Five, Enforcement.) The requirements of the new regulations would be phased in during a transition period. (Page 92)

Run Tickets

4. That the Department seek legislation or publish regulations, as necessary, to require truck haulers of oil to have run tickets in their possession at all times while transporting oil from Federal and Indian leases.(Page 95)

Expand Inspectors' Authority

5. That the Department seek legislation to empower Federal inspectors (within constitutional limits) to stop trucks in order to check that the truck hauler possesses a run ticket. (Page 96)

State and Local Enforcement

6. That the Federal government establish cooperative relationships with State and local enforcement officials and encourage them to use their authority to inspect for run tickets in the possession of haulers of oil and to deter oil theft generally. (Page 96)

Undocumented Oil

7. That the Department seek Federal legislation to prohibit the purchase of undocumented crude oil and require purchasers of crude oil up to and including refiners to keep documentation showing from whom they purchased the product and from what lease or unit. (Page 96)

ENFORCEMENT

Inspection/Enforcement Strategy

1. That the Federal royalty managers design and implement an inspection/enforcement strategy which will assure that the performance of the industry, both in assuring site security and in reporting production volumes, is properly monitored. This strategy should include how often and in what manner the field staff will inspect sites, how violations will be determined and penalties assessed, what other methods will be used to ensure site security and to verify production on site, and how the managers of the Federal royalty program will use the program's resources, both present and future, to carry out this strategy. To implement the strategy the Department should:

   - Increase the number of Federal inspectors so that at a minimum each Federal and Indian lease can be inspected once a year for site security and production verification purposes. (A minimum of 83 inspectors devoting 100 percent of their time to these two duties.)

   - Increase the frequency of inspection beyond the once a year minimum, by entering into cooperative agreements with States and Indian tribes and by using contractors as necessary to assist with the monitoring of the site. (See Chapter Six for further discussion of this recommendation.)(Page 103)

Fair But Firm Enforcement

2. That the Secretary direct employees of the Federal royalty program that he expects enforcement of the program's regulations to be conducted fairly, but firmly, with penalties imposed when violations are found. (Page 109)

Civil Penalties: Site Security

3. That the Department seek legal authority to assess civil penalties for site security violations. The civil penalty system should have fines up to $10,000 per violation, and under certain circumstances, each day should be counted as a separate violation.

   After the legislation is enacted, appropriate criteria for levying fines should be developed and promulgated after publication in the Federal Register for review and comment.

   These criteria should include the operator's history of violations, the potential for theft, negligence of the operator, and good faith in compliance. Civil penalties should be imposed both for violations detected for the first time and for noncompliance, that is, failure to obey an order. (Page 109)

Civil Penalties: Payments

4. That the Department seek legal authority for a civil penalty system for nonpayments, late payments, underpayments, error ridden reports, and failure to submit or update the required payor plan.

The Internal Revenue Service's system of a sliding penalty scale based on the culpability of the payor and harm to the government could be used as a model. As applied to royalty collections, this would provide that failure to report would result in a penalty of 5 percent per month of the royalty owed up to a maximum of 25 percent, unless the payor shows that his failure to report is due to reasonable cause and not willful neglect. Chronically error ridden reports would be treated as a failure to report.

Also, there should be a penalty for failure to pay the royalty when due of one-half of one percent per month of the amount owed, up to a maximum of 25 percent.

Where underreporting represents 25 percent or more of the amount owed and is willful, the USGS should impose a civil penalty of 50 percent of the total unpaid royalties due. Penalties would be applied in addition to interest levied on the delinquent royalties. (Page 110)

Shut-in: Site Security

5. That the Federal royalty managers use shut-in authority in cases of noncompliance where there is serious potential for theft. Operators should be charged the value of the average daily royalty that otherwise would have been paid had the lease not been shut-in, as liquidated damages or penalty. (Page 110)

Shut-in: Underpayments

6. That the Secretary of the Interior exercise his authority to use shut-ins and lease cancellations as sanctions for severe cases of underpayments. Operators should be charged the value of the average daily royalty that would otherwise have been paid had the lease not been shut-in, as liquidated damages or penalty. (Page 111)

Lease Cancellation

7. That the Secretary pursue lease cancellation in cases of repeated theft or serious lease security problems.(Page 111)

STATES AND INDIAN TRIBES

Expanded Policy

1. That the Secretary announce an expanded policy of cooperation with States and Indian tribes in the royalty management area--namely, that the Department will share information and royalty management functions (including inspections) with affected States and Indian tribes to the maximum extent possible, consistent with its responsibility to assure the proper accountability of the royalties paid on minerals removed from Federal and Indian lands. (Page 123)

Secretarial Advisory Committee

2. That the Secretary appoint a formal advisory committee, reporting to the Secretary's Office, consisting of representatives of States and Indian tribes and related organizations and Departmental officials, to develop over a nine-month period a detailed plan for carrying out the expanded policy of Federal/ State/Indian cooperation on a comprehensive basis. (Page 124)

Immediate Implementation

3. That the Secretary immediately take steps to assist States and tribes in carrying out certain royalty management functions, by:

   ° Offering to enter into demonstration cooperative agreements with interested States and Indian tribes, especially for inspection of leases, audits, and training and to participate in the funding where appropriate.

   ° Providing for increased technical support of Indian royalty management activities through the BIA's Division of Energy and Minerals in the Office of Trust Responsibilities and (since Osage Tribe activities are budgeted separately from those of other tribal and Federal leases) assuring that the Osage Tribe has inspectors adequate to conduct inspections for site security and production verification at each lease at least once a year.

   ° Seeking legislation as necessary to enhance a State's or Indian tribe's ability to carry out royalty management and site security functions under cooperative agreements with the Department. Specifically, the program should authorize the enforcement of all applicable Federal laws and regulations by States and tribes (operating under a cooperative agreement with the Department) and their obtaining information from companies and others to the same extent as if they were employees of the Department. Any cooperative agreements should provide for the transfer of funds to the States and Indian tribes for an appropriate portion of the costs, based on the source of the funds and the respective responsibilities of the parties. (Page 126)

Information Exchange

4. That the Department substantially increase the two-way flow of information between the Department and the States and tribes by:

   ° Actively supporting the ongoing effort of States to develop common data elements for industry reporting, and by examining Federal data needs to make the Federal data collection effort as consistent as possible with the States' efforts.

   ° Identifying those sources of information which States and tribes have which will assist the Federal royalty managers in assuring that royalties collected are correct and site security rules are observed; and entering into agreements with these States and tribes to obtain this information on a routine basis.

- Designing and implementing a system of sharing with the individual States and Indian tribes on a timely basis all information which the Federal royalty program collects concerning leases within their respective boundaries, including information at the time the checks are distributed to verify the accuracy of the royalty payments and to audit the accounts if necessary.

- Continuing and expanding upon the past USGS policy of making forecasts of future royalty revenues when requested to do so by a State or Indian tribe.

- Creating a central data bank of Federal, State, and Indian audit and site inspection results so that Federal, State and Indian auditors and inspectors can have a comprehensive source for checking royalty payor and/or lease operator performance. (Page 130)

Self-Sustaining Fund: Purpose

5. That the Secretary of the Interior seek legislation to establish a self-sustaining fund which would:

- Pay the costs of supplementary audits and lease production related inspections that are above those planned for and funded by the routine Federal royalty management budget. No environmental or site safety inspection functions would be financed by this fund and the fund would not be used as a substitute for a full audit and inspection program under the routine Federal royalty management budget.

- Reimburse States, localities, and Indian tribes for costs they might incur for their part in any audits, inspections or enforcement done under cooperative or contractual arrangements with the Federal royalty managers with regard to mineral leases on Federal and Indian lands. Federal costs associated with the cooperative agreements would also be covered. These activities would include only those efforts done solely by the States, localities, or Indian tribes, those done jointly with the Federal royalty managers, and those done by contractors for any of these parties, under the terms of a cooperative agreement. (Page 134)

Self-sustaining Fund: Levy

6. That the Secretary establish and maintain the fund by taking a percentage of the royalties collected from all existing and future Federal and Indian leases (both offshore and onshore) before any funds are distributed to the States, Indians, or the U.S. Treasury.

   That the legislation allow the Secretary, after the first five years, to adjust the level of the levy between zero and one percent of the total royalties collected. For the first five years, the levy should be set at one-half of one percent of such royalties. The yearly budget for the fund should be subject to Executive Branch and Congressional review and approval. After the first five years, the fund balance should not be allowed to exceed an amount equal to the sum of the funds expended from the fund for the previous three years. In the event that the levy would result in excess monies accumulating in the fund, the Secretary would be required to adjust the fund by reducing the levy rate or by suspend ing the levy (reducing it to zero) for an appropriate period.(Page 135)

Sharing Penalties and Interest

7. That the Federal government share with the States and Indian tribes both interest and penalties paid for late payments and underpayments. (Page 137)

Accelerated Payments to Indians

8. That Indian tribal royalty payments be deposited immediately in interest bearing accounts and electronic transfer be actively encouraged; and that the Department seek ways to accelerate distribution of royalty payments to the individual Indian landowners. (Page 137)

Accelerated Payments to States

9. That distribution of royalty funds to the States be made as quickly as possible after the close of the reporting period, and that the Secretary consider seeking legislation to allow payment of the States' share of royalties more frequently than once every six months.(Page 137)

ORGANIZATIONAL ISSUES

Create New Office of Royalty Management

1. That the Secretary immediately move the royalty management program out of the USGS to a location to be determined by the Secretary, but reporting to an Assistant Secretary or perhaps the Under Secretary.

   In order to function as an organizational entity, royalty management must include the following post-lease functions from the USGS Conservation Division:

   - Accounting
   - Auditing
   - Product valuation
   - Data collection
   - Regulation writing
   - Enforcement (monitoring, inspection, sanctions)
   - Engineering technical support

   It must have its own inspection personnel. It must also have the authority to cooperate with the States and Indian tribes and to negotiate cooperative agreements for the Secretary's signature. Additionally, in order to ensure that the royalty management program functions smoothly, it must have at least the following support services: computer, procurement, budget, and personnel.

Finally, it should have the authority to deal at the policy level within the Department. (Page 159)

Transition Project Director

2. That the Secretary appoint a transition project director in order to assure that the reorganization is completed in an appropriate manner and that the Commission's recommendations are implemented expeditiously.

   The transition project director would report directly to the Secretary, the Under Secretary or an Assistant Secretary. This transition director would have the authority to assure that the royalty management program is correctly separated out from the USGS and that implementation of the Commission's recommendations as approved by the Secretary is expeditiously undertaken. He or she would be responsible for the Secretary's advisory committee of State and Indian representatives and the preparation of the first annual report of the Secretary. This person would be in addition to the project leader for the new royalty management system recommended in Chapter Eight of this report. (Page 160)

Study of BIA/BLM Royalty Management Functions

3. That the Department initiate a study of what lines of communication should be established between the royalty management functions being

moved from the USGS and other royalty management functions located in BIA and BLM. In addition, the Department should study which parts of the BIA and BLM royalty management functions might be combined with the USGS royalty management functions at a future time. (Page 161)

Qualifications of Director

4. That the director of the new royalty management office be an experienced manager preferably with a background in financial management. His or her most important qualification should be strong management expertise, not program knowledge; however, if possible it would be desirable for the office director to be familiar with the minerals industry. (Page 161)

Nationwide Search

5. The Department should initiate a nationwide search for an office director. He or she must have the status of a bureau-level director within the Department, reporting at least to the level of an Assistant Secretary. The director must have clearly delegated authority in order to respond expeditiously to changing needs.

   High level placement within the Department and clearly delegated authority will make this position attractive to the financial community, encouraging high quality candidates to apply.(Page 161)

NEW APPROACHES TO ROYALTY MANAGEMENT

Advance Implementation of Financial System

1. That, where appropriate, those parts of the Auditing and Financial System which are not already in place be implemented on an advance basis (manually or otherwise) before full automation is completed. (Page 167)

Advance Implementation of Production System

2. That appropriate portions of the Production Accounting and Auditing System be implemented on an advance basis (manually or otherwise) before full automation is completed.(Page 170)

Immediate Implementation of Production System

3. That since the Production Accounting and Auditing System is so important to the proper functioning of the royalty management system, the Secretary take the necessary steps to assure that adequate financial and human resources are available through reprogramming or otherwise for prompt implementation after the design is completed in the spring of 1982. (Page 170)

Modification of Improved Royalty Management System

4. That the managers of the Federal royalty program proceed with the implementation of the improved royalty management system, as modified by the Commission's recommendations in this report, and that the Federal royalty managers immediately take steps to incorporate the recommendations of the Commission in the design and implementation of the new system. (Page 175)

Omnibus Royalty Management Improvement Act

5. That the Secretary appoint a Committee of Department officials to draft a proposed Omnibus Royalty Management Improvement Act and that the Secretary provide guidance to the Committee in the form of approval of those Commission recommendations with which he is in accord. (Page 175)

Project Manager

6. That a project manager be immediately appointed reporting to the transition director until appointment of a head of the Royalty Management Office to oversee implementation of the new royalty management system. The authority of the project manager should be in writing and his authority should be broad enough to resolve disputes among senior program managers or to have

them resolved by the director in a timely fashion. (Page 175)

Annual Report

7. That the Secretary prepare an annual report on the implementation of those Commission recommendations adopted by the Secretary and the overall progress of the improved royalty management system. The report should be made available to appropriate committees of Congress and to the public. It should be issued on March 1 of each year, up to and including March 1, 1986. Prior to its transmittal, the Secretary should provide a copy of the draft report to mineral producing States and Indian tribes and should include their comments as part of the report when it is published. (Page 177)

Windfall Profit Tax

8. That the Department request the assistance of IRS to revise its regulations or design a legislative change which would relieve the Federal royalty program of the responsibility of calculating and paying the Windfall Profit Tax on royalty in-kind transactions; and

   That the responsibility for calculating, withholding, and paying the Windfall Profit Tax on all crude oil sold on Federal leases be returned to the industry, with oversight by the IRS rather the Federal royalty management program. (Page 179)

Increased Royalty Rate

9. That the Secretary take the necessary steps to implement the use of a minimum royalty rate of 16-2/3 percent for new or renegotiated oil and gas leases, except where requested not to do so by an Indian tribe or Indian landowner. (Page 180)

STATEMENT OF JAMES R. RICHARDS, INSPECTOR GENERAL, DEPARTMENT OF THE INTERIOR

Mr. RICHARDS. Thank you, Mr. Chairman. It is a pleasure to be here before this subcommittee to discuss the Office of Inspector General audits concerning the oil and gas on Federal and Indian lands. I have a statement on file, and I assume it will be submitted for the record. I will briefly summarize my statement to save time.

Senator MELCHER. Your entire statement will be made part of the record, and we appreciate your summarizing it.

Mr. RICHARDS. Thank you.

Problems associated with the royalty management system gained national attention in 1981 and 1982, as you have mentioned in your opening statement, when the Linowes Commission published its report. The Commission was appointed by the Secretary of the Interior in 1981 to investigate reports of theft of oil and underreporting of royalties of oil and gas leases on Federal and Indian lands.

The report contained recommendations for improving the royalty collections and the organization and direction of the royalty program.

Although we identified in a series of audits that we did called look-back audits, potential underpayments and other problems, some of them substantial, associated with the administration of the program by Interior bureaus, we did not uncover any evidence of widespread theft of oil or any intentional or fraudulent underpayments.

What we did find, which is summarized in our reports, are potential underpayments that certainly needed to be aggressively collected.

Our most recent biennial report concerning the royalty management program issued a few weeks ago indicated that while improvements are still needed, the Department has taken significant corrective actions on the problems identified and appears to be firmly committed to an effective and efficient royalty management system.

We recently issued four reports on audits that were undertaken to determine if the Minerals Management System was accomplishing its mission in an efficient and effective manner, and I shall briefly summarize these reports.

The first report had to do with the Valuation Standar[illegible] Division of MMS, and that was issued on March 31, 1988. In this audit we reported that the service did not finalize product valuation regulations and guidelines for oil, gas and coal royalties in a timely manner. The publication of the final regulations was delayed for almost five years. Some of that frankly was due to factors beyond MMS control, but some of it was due to bureaucratic delay.

The second audit was of the Royalty Compliance Division dated April 1, 1988. This report indicated that the Service did not provide adequate audit coverage of the lease universe during a six-year period ending September 30, 1987.

What is more, the lease coverage was inadequate because the division had not developed an audit inventory or six-year audit plan. Resident audit staffs we visited had comprehensively audited less than 2 percent of their lease universe in Fiscal Years 1986 and

1987, because substantial audit resources, 38 percent, were spent reviewing claimed over-payments by payors and reconciling lease balances.

The next audit was of the Fiscal Accounting Division dated April 1, 1988. In this audit we reported that the Service needed to improve procedures in disbursing and accounting for Federal and Indian mineral revenues.

The other recent audit, the fourth one, was of their Production Accounting Division, which was also dated April 1, 1988. We reported that planned automated onshore system which will cross-check sales and production data for onshore leases may not be cost effective or efficient for fulfilling the Division's mission of providing onshore production, accounting and reporting.

A year and a half or two years ago, we also issued two other significant audit reports that you had asked us to summarize. The first has to do with the Drainage Protection program of the Bureau of Land Management dated November 13, 1986. Drainage is the migration of oil or gas in one reservoir to another lessee's property without just compensation.

The report indicated that the Bureau of Land Management's drainage casework was seriously backlogged, 8,400 cases equating 53 years of staff workload, because drainage protection was given a low priority and directions provided by the Bureau's headquarters were confusing.

The other report that you asked us to discuss, another older report on the Inspection and Enforcement Program of the Bureau of Land Management, is dated June 23, 1986. This report concluded that the Bureau's management had not adequately supported the program. Far fewer inspections were performed and planned, and independent production and sales volume verifications were rarely performed.

The Office of Inspector General will continue reviews of the Department's Royalty Management Program as well as some of the audits of royalty payor programs or companies.

Finally, although there are still problems, I would like to emphasize that we believe the Department has made considerable progress since the Linowes Commission report and the enactment of the Federal Oil and Gas Royalty Management Act in improving the management of royalty collections and disbursements and appears to be committed to an effective royalty management system.

This completes my prepared statement or a summary of it, and I would be glad to respond to any questions.

[The prepared statement of Mr. Richards follows:]

OPENING STATEMENT OF JAMES R. RICHARDS
INSPECTOR GENERAL, U.S. DEPARTMENT OF THE INTERIOR

OVERSIGHT HEARING ON THE DEPARTMENT OF INTERIOR'S ROYALTY MANAGEMENT SYSTEM BEFORE THE SENATE SUBCOMMITTEE ON MINERAL RESOURCES DEVELOPMENT AND PRODUCTION OF THE ENERGY AND NATURAL RESOURCES COMMITTEE

MAY 23, 1988

Mr. Chairman, members of the Subcommittee, I am pleased to appear before you today and discuss Office of Inspector General audits concerning oil and gas on Federal and Indian lands. As you know, this office was created under the Inspector General Act of 1978 to promote economy and efficiency and to detect and prevent fraud and abuse in the Department's programs and operations. We also provide a means to keep Department heads and the Congress fully and currently aware of problems and deficiencies uncovered by our audit and investigative efforts.

Problems associated with the royalty management system gained national attention during 1982 when the Linowes Commission published its report. The Commission was appointed by the Secretary of Interior in July 1981 to investigate reports of theft of oil and underreporting of royalties from oil and gas leases on Federal and Indian lands. The report contained recommendations for improving royalty collections and the organization and direction of the royalty management program.

As a result of a Linowes Commission recommendation and Congressional mandate, the Office of Inspector General participated in a number of audits of royalties paid on oil and gas leases on Federal and Indian lands. In that effort we conducted a series of audits of 34 of the top 50 royalty payors, of 10 Gulf Coast gas processing plants, of 10 of the second 50 largest royalty payors, and of the major missions and functions of the Royalty Management Program within the Department. These audits identified a total of $160.2 million in potential royalty underpayments and a number of other problems with the Royalty Management System.

Although we identified potential underpayments and other problems associated with administration of the program by Interior bureaus, we did not uncover any evidence of theft of oil or any intentional or fraudulent underreporting of royalties. Royalty underpayments were caused by several factors, including lack of clear guidance on valuation issues, inadequate financial and accounting systems and lack of management attention to inspection and enforcement activities. Our most recent biennial report concerning the Royalty Management System, issued a few weeks ago, indicated that while improvements are still needed, the Department has taken significant corrective actions on the problems identified and appears to be firmly committed to an effective and efficient Royalty Management System. I am here today to discuss several recently completed audits and several others completed in the past two years that impact the management of the Royalty Management System.

We recently issued four reports on audits that were undertaken to determine if the Minerals Management Service was accomplishing its mission in an efficient and effective manner. I shall briefly summarize these reports.

Valuation And Standards Division, Dated March 31, 1988 - In this audit we reported that the Service did not finalize product valuation regulations and guidelines for oil, gas and coal royalties in a timely manner. Publication of the final regulations was delayed for almost 5 years. The Division expended most of its time during fiscal year 1986 resolving "standard issues" on a case-by-case basis that could have been handled by industry personnel if uniform guidelines had been issued. As a result, 74 percent, or $1.1 million annually, of the Division's staff resources were not used efficiently or effectively.

We recommended that the Service, (1) expedite the publication of final regulations and guidelines and (2) review Division personnel requirements and retain only those employees required to maintain regulations and respond to questions on regulatory and policy issues. The Service agreed with the two recommendations. Final oil and gas regulations were published on January 15, 1988, with an effective date of March 1, 1988 and the Service is reevaluating its staffing needs.

Royalty Compliance Division, Dated April 1, 1988 - This report indicated that the Service did not provide adequate audit coverage of the lease universe during the 6-year period ending September 30, 1987. Lease coverage was inadequate because the Division had not developed an audit inventory or a 6-year audit plan. Resident audit staffs we visited had comprehensively audited less than 2 percent of their lease universe in fiscal years 1986 and 1987 because substantial audit resources (38 percent) were spent reviewing claimed overpayments by payors and reconciling lease balances, and the Division had not allocated audit resources according to the number of leases and the revenues collected.

We recommended that the Service, (1) compile a lease inventory, (2) develop a 6-year audit plan that includes auditing revenues collected in fiscal year 1982 before the records are no longer available, (3) eliminate or minimize audit work on refund requests and reconciliations, and (4) distribute audit resources based on work load requirements. The Service agreed with the recommendations and is taking positive corrective actions.

Fiscal Accounting Division, Dated April 1, 1988 - We reported that the Service needed to improve procedures in disbursing and accounting for Federal and Indian mineral revenues. Specifically, the Division had not determined the proper disposition of $227,000 in reported overrecoupments of royalties on 285 Indian leases because Division personnel considered this work load to be low priority, nor had they reconciled 1,300 payor account balances including accounts with $16.8 million in reported royalty underpayments. Also, they had not implemented adequate procedures to ensure that the disposition of $7.6 million in reported underpayments was effectively resolved, nor had they assessed liquidating damages of about $539,000 against payors for erroneous reporting, and they had not disbursed about $3.1 million in royalties in a timely manner or to the proper recipient.

The Minerals Management Service took actions to ensure that (1) reported overrecoupments taken on Indian leases are reviewed and corrected on a timely basis and (2) that payor accounts are reconciled on a permanent and continuing basis. Also, the Service reported that criteria and procedures have been changed to allow for the timely disbursement of royalties. The Service disagreed with our recommendations relating to assessing liquidating damages on warning errors and investing royalties collected on Section 8(G) leases. We are requesting that the Service reconsider its position on these 2 remaining recommendations.

Production Accounting Division, Dated April 1, 1988 - We reported that the planned automated onshore system, which will cross-check sales and production data for onshore leases, may not be cost-effective or efficient for fulfilling the Division's mission of providing onshore production accounting and reporting.

We recommended that the Service limit the implementation of the automated onshore system to one location to ensure that (1) the system meets known requirements, (2) that it does not generate more exceptions than can be efficiently processed, and (3) that it provides the benefits intended at an acceptable cost. Management disagreed with the recommendation and stated that the cost-effectiveness of the system will be analyzed when 50 percent of the leases are automated. However, the analysis will not be completed until after full implementation occurs. Therefore, we are requesting that management reconsider its position before proceeding.

During the last two years, we also issued two reports covering oil and gas activities of the Bureau of Land Management, including the Drainage Protection and Inspection and Enforcement Programs.

Drainage Protection Program, Dated November 13, 1986 - Drainage is the migration of oil or gas in one reservoir to another lessee's property without just compensation. The report indicated that the Bureau of Land Management's drainage case work was seriously backlogged (8,400 cases equating to 53 years of staff work load) because drainage protection was given a low priority and directions provided by the Bureau's headquarters were confusing. In addition, personnel did not have the necessary experience to adequately analyze drainage cases. Further, formal notices of potential drainage were not sent to lessees in a timely manner, unleased lands were not referred to state offices for leasing, and a system for tracking the status of pending drainage cases was not established. We found that the Bureau's lack of support for the drainage protection program could result in the loss of over $6.4 million to the Government and Indians.

The Bureau, in response to our report indicated that it had (1) increased the priority of the program, (2) increased program funding and staffing, (3) prepared improved guidance and regulation, and (4) reduced the drainage case backlog. (The Bureau recently reported that the case backlog had been reduced from 8,400 to 4,600 cases.) In addition, the Bureau agreed with our recommendation for the need for improved technical training and has taken action to implement an improved training program.

Inspection And Enforcement Program, Dated June 23, 1986 - The report concluded that the Bureau's management had not adequately supported the Program. Far fewer inspections were performed than planned, and independent production and sales volume verifications were rarely performed. Few inspections were performed because state offices had not increased the number of inspectors to authorized levels, inspectors were not assigned to inspection and enforcement programs, and inspectors spent more time on clerical duties than on performing inspections. Consequently, the program did not meet the principal objective of the Act, which is to ensure accountability over oil and gas produced and sold from public lands. Also, oil and gas regulations were not uniformly interpreted, enforced, and implemented because the Bureau's management had not always identified or addressed important regulatory issues in a timely manner.

In response to our recommendations, the Bureau indicated that it: (1) clarified oil and gas regulations, (2) provided additional training to inspectors, and (3) developed oil transporter inspection procedures. The Bureau has advised us that it is currently taking actions to (1) revise its inspection and enforcement strategy document to specify frequency of inspection requirements and address verification of production and sales volumes and (2) prepare onshore orders to ensure uniform implementation of oil and gas regulations.

The Office of Inspector General will continue to conduct reviews of the Department's Royalty Management Program as well as some audits of royalty payor companies. Finally, although there are still problems, I would like to emphasize that we believe the Department has made considerable progress since the Linowes Commission report and the enactment of the Federal Oil and Gas Royalty Management Act, in improving the management of royalty collections and disbursements, and appears to be committed to an effective Royalty Management System.

Mr. Chairman, this completes my prepared statement. I would be pleased to answer any questions you or the subcommittee members may have.

Senator **Melcher**. Thank you.
Mr. Bettenberg.

STATEMENT OF WILLIAM D. BETTENBERG, DIRECTOR, MINERALS MANAGEMENT SERVICE, DEPARTMENT OF THE INTERIOR, ACCOMPANIED BY KENNETH M. MOYERS, CHIEF, ROYALTY COMPLIANCE DIVISION

Mr. **Bettenberg**. Mr. Chairman, I am pleased to be here. I would also like to ask that my prepared remarks be placed in the record. If you will, for a couple of minutes I would like to walk you through several charts that I have.

Senator **Melcher**. Your entire statement will be made part of the record at this point. Please proceed.

Mr. **Bettenberg**. Mr. Chairman, many times people look at the Royalty Management Program and come to what we conclude are improper conclusions because they have not looked at the entire program as a whole. I would like to walk you very quickly through the major elements of the program, note areas where we have been making changes over the last few years, and then make a couple of concluding remarks.

First is how we treat royalty management in the Minerals Management Service process. There are five steps in the basic process. The first one is that companies are responsible for making payments and reporting information to us. That seems obvious, but it is where we start with the process. A company gets a lease, and as they go on production they have to start reporting and making payments.

We in the Minerals Management Service and the Royalty Management Program are responsible for collecting that money and for processing the information that we get. In many cases that money goes to a variety of recipients: to States, some $400 million a year; to Indians, roughly $70 million a year right now; large portions also go to the Land and Water Conservation Fund, Historic Preservation Fund and other places.

We are also responsible once we get this money to get the information for verifying that it is correct, and that is an important responsibility that we have.

Finally, we are responsible for taking enforcement action when we see that that is not happening.

So we have a process of a variety of steps all constituting a single program. Through the verification and enforcement program we loop back into the payment and reporting when we find problems so that we are informing companies of errors that they are making.

Over the last few years, we put together a whole series of payment and reporting regulations. The last of those came out just this past month with regard to onshore reporting of production. We had a whole series for reporting payments, production and so forth over time.

We have been in the process, as Mr. Richards indicated, of putting out product value guidance for too long a period of time. He did not note that for one year of that period we were prohibited by Congress from issuing the guidance, but we now have the oil and gas product value guidance updated and out. It was published in January and implemented the first of March.

We are still working on coal guidelines. We would describe them as in process. We were prohibited for a period from issuing them as well. At this point we are hoping to put out reproposed rules in July and final rules in December.

This committee was very helpful in clarifying requirements of NTL-5. That legislation was passed in December, and our guidance to industry went out in February of this year.

We have also prepared a series of payor/reporter handbooks so that companies are on notice as to precisely how they are supposed to fill out all of the forms, what they are supposed to report and so forth. We are in our second edition of that for the financial accounting part of the operation, and we have the same kinds of materials out for industry for production accounting as well.

We have also had a major effort in payor/operator training. We gave training presentations to some 1,200 company personnel just a couple months ago in terms of new requirements for oil and gas product value and on NTL-5.

Last year we cycled through training for about 900 different operators in terms of production accounting. We have had similar programs for various companies that report to us. We have found that very frequently the cause of errors is simply lack of knowledge on the part of those who are supposed to pay and/or respond.

I indicated we are responsible for collection and processing. We have implemented a series of systems over the last few years. Bonus and rental accounting systems for nonproducing Federal leases went into effect in 1984. That system is essentially trouble-free. It was developed on time and within budget.

The AFS is our financial accounting system. It is the one that collects the money for actual royalties. That has been a problem-plagued operation that we started back in the late 1970s and began implementing at the beginning of 1983. Some serious mistakes were made in terms of choice of computer and the system was too finely tuned for the job at hand.

In order to resolve that, we needed to shift the operation from mini-computers to a main-frame computer. We completed that conversion last August, went live with it in September, and it has been functioning extremely well in the new computer environment.

One of the things that we had to do in that process was to freeze the software while we were making the conversion, and that was frozen for several years. In the interim, we developed a team of people to start figuring out what kinds of improvements we wanted to make to that system. That effort is well along.

We have worked with the Indian tribes, the States and industry in terms of getting everybody to agree what kinds of improvements needed to be made to the system.

We have begun making what we call short-term improvements this year, those things that we can do quickly. Within the next couple of months we should complete our study on how to make those improvements that we think we can make in the long term.

The kinds of improvements we are making are those which will reduce the reporting burden so far as industry is concerned, speed payments to States and Indians, and simplify the system from the standpoint of ease of operation.

The third system that we have implemented is our production accounting system. It is operational for offshore oil and gas, onshore solids and about 20 percent of the onshore oil and gas. That system has been operating for several years and functions extremely well.

For onshore oil and gas we are in the process of implementing the remaining 80 percent of the onshore reporting at this point.

The first district comes on line in that effort next month. We shifted our emphasis from the kinds of reporting that we had for offshore into essentially mirroring the Bureau of Land Management 3160-6 reporting system so that industry would not have as much of a problem in converting. We think that this is a worthwhile endeavor. We are scheduled to have completed all of the Bureau of Land Management district offices by May of next year.

We have also gone through major data base cleanup efforts. Those are completed at this point. As the new system was brought on line in 1983, it was operating with the sort of data that existed in the old system. Much of that data was wrong.

As a result of all of this, we added some 69 leases to the system that simply were not being accounted for before. There were 300 plus nonproducing leases that were not in the system before. We have at this point cleaned up those elements of the data that we have a need to use. There are some fields in our system that have data which have not been reviewed because they are not currently being used.

We also have an additional system to make certain that we keep the data base clean with regard to Federal leases. That is called IDVS for short. It is an Interagency Data Verification System. On a regular basis we compare the lease data between our systems and the Bureau of Land Management, so we make sure we are operating from the same data.

In the distribution and explanation area, since the implementation of FOGRMA in the fall of 1983, we have been making monthly distributions of money and monthly reports explaining payments. Those are both new.

We have done a lot of training with the States and with the Indians. There are some data that those groups wanted that we could not initially give them access to on a regular report basis. So we essentially downloaded all of the data in the system and developed a small system that gives different groups access on line to our computer.

That system has been implemented with, I think, nine States and eight or nine tribes probably and some 14 Bureau of Indian Affairs offices. They can dial up in most cases with the computer we provided to them and access the data that are pertinent to them. So they have access to all of the data that are in our fiscal accounting system.

In the verification area, in 1985 we implemented exception processing, trying to detect a variety of kinds of errors, late payments, nonpayments and so forth. That is new. That has had a nice payoff of approximately $32 million in additional payments in the last couple of years.

Our production accounting, as I indicated previously, is a new system. That has generated an additional $20 million because we are able to compare the production which is reported from operators with the royalty payments made by payors.

We are heavily involved at this point in the production verification area. Mr. Robison, I am sure, can touch on that with regard to the onshore area of Bureau of Land Management leases.

In the offshore area, in some areas we have been verifying 100 percent of the production. We have an automated system that goes into operation as well for oil, and at this point we are studying the gas situation.

Finally, we have a major audit program. That program has generated something in the neighborhood of $429 million in additional actual collections over the last four or five years. We have another $200 million plus for which we have issued findings that are bonded and under appeal. So we have a total production from that unit at this point of some $600 million.

Finally, in the enforcement area we developed and implemented an enforcement strategy. It specifies those circumstances in which we will charge companies for erroneous reporting and those situations in which we will use the various kinds of legal authority that we have at our disposal to make collections.

We have been collecting interest for late payments. That totals roughly $18 million that we have collected over the last few years. We assess liquidated damages when companies supply reports that are in error to us.

One indication of the kind of job we are doing, I think, is in the appeals and litigation area. Before the Minerals Management Service was created in 1982, in a typical year there were roughly 40 appeals made to the Director of the Geological Survey. At this point companies are protesting between 300 and 500 cases per year where we are going after them for additional money.

There are 142 cases currently before the Interior Board of Land Appeals, and we are pursuing some 100 cases in the courts. Those range from major policy issues to bankruptcy situations where we are trying to enforce the Federal law.

Mr. Chairman, that is the cycle that we go through with regard to the program. We think that in fact we have made very significant progress.

One thing that I would like to note in that regard is that I think all of us were disappointed in terms of the amount of time it took to bring this program together. I think at this point it is essentially together.

One way of understanding what the difficulty was in that regard is not only have new systems been implemented but essentially an entirely new work force has been hired. We have approximately 640 employees in the Royalty Management Program today. Of those, 31 were involved in the old royalty program, let us say, roughly prior to about the middle of 1981.

The operation was consolidated in Denver. The systems were designed and implemented by essentially a new Federal work force. Those people had to be learning the royalty management process as well as the system that they were working with, and I think that that slowed the implementation a fair amount.

I have with me several people who I would like to introduce, and I may need to call on them for technical responses on some of the questions that you might have.

Jerry Hill is our Associate Director for Royalty Management. Jerry is in charge of the Royalty Management Program. He has been with us now about two and a half years, and has some 20 years experience in the royalty management area in the State of Louisiana. He was the undersecretary of two separate departments. He also has had a few years of experience in accounting with industry.

Don Sant is our Deputy Associate Director for Audit and Valuation, and I guess you could say he is responsible for product valuation and thinking through that kind of process. He comes well equipped to do that job.

Jimmy Mayberry is our Deputy Associate Director for Collection and Disbursement.

Jim Detlefs is the chief of our Fiscal Accounting Division.

Ken Moyers is Chief of our Compliance Division or chief auditor, if you will.

Lucy Querques is in charge of production accounting.

Among this group, there are a number from GAO. A number of them either separately or in combination with GAO experience spent six to eight years in the Department of Energy price control business dealing with oil. In point, most of these people have four, five and six years experience with the Minerals Management Service and the royalty compliance business.

It is a good management team, and I think that they are making good progress.

[The prepared statement of Mr. Bettenberg follows:]

OPENING STATEMENT OF WILLIAM D. BETTENBERG
DIRECTOR, MINERALS MANAGEMENT SERVICE

Before the
Senate Energy and Natural Resources Committee
Subcommittee on Mineral Resources Development and Production

May 23, 1988

I want to thank the Chairman and members of the Subcommittee for the opportunity to discuss the Royalty Management Program of the Minerals Management Service (MMS). The Department of the Interior (Department) has been collecting bonuses, rents, royalties, and other receipts from Federal and Indian mineral leases since 1921. The MMS has been responsible for this function since its establishment in 1982, and within MMS, the Royalty Management Program is specifically responsible for the collection and disbursement of bonuses, rents, royalties, and other receipts from Federal and Indian oil, gas, coal and other mineral leases onshore, as well as from the Outer Continental Shelf (OCS) leases. As members of the Subcommittee are aware, this program provides significant revenues to the Treasury, accounting for an estimated $5.3 billion in Federal receipts in 1989, including $4.4 billion from OCS bonuses, rentals, royalties, and interest, and $0.9 billion from onshore mineral leasing.

Since 1982, the Department has intensified the attention given to the processes of royalty accounting to insure that mineral lease revenues are collected, accounted for, and distributed properly.

I would like to provide an overview of the Royalty Management Program and highlight some of our achievements during the past year or so, demonstrating our continuing commitment to seek improvements to MMS's Royalty Management Program (RMP).

Overview of the Royalty Management Program

The RMP consists of five primary elements: payment, collection, distribution, verification, and enforcement.

I. Payment and Reporting

Owners of nonproducing Federal and Indian leases are, by regulation and lease terms, typically required to pay an annual lease rental fee based on acreage. This is a relatively simple calculation. Approximately 61,000 Federal leases are in this status. Lessees make these payments to MMS for Federal leases and to a tribe, allottee or the Bureau of Indian Affairs (BIA) for Indian leases.

Owners of producing leases are typically required by the last day of the month following the month of production to pay a royalty on the value of production removed or sold from a lease. This is a far more complex calculation involving computation of product quantity and quality (sometimes for many products), value, processing allowances, and transportation allowances. A lease may have more than one owner and the products may be sold to more than one purchaser at a variety of prices. Many producing leases are part of a production unit or communitization agreement whereby production from a group of leases is allocated to individual leases by agreement. These units can involve various combinations of Federal, Indian, State, and private lands.

Another factor complicating payment is that many payments are made on an estimated basis and require adjustment because actual volumes and prices are not available at the time royalties and royalty reports are due. Also, transportation and processing allowances are normally based on estimates and adjusted to actual amounts on an annual or biennial basis. Finally, a substantial portion of minerals production is sold at less than arm's-length; thus values placed on intra-company product transfers may not reflect market values. All told, payors and operators are required to report production and payment data and make payments monthly to MMS on 22,000 Federal and 4,000 Indian leases involving about 80,000 different combinations of leases, products, and selling arrangements.

Although royalty reporting and paying can be a complex and demanding responsibility, MMS has done several things to assist payors in complying with requirements. Payment and reporting regulations have all been rewritten since the passage of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), and address payor concerns wherever possible. The payor handbook, which contains detailed instructions and reporting examples for virtually every royalty reporting situation, has recently been rewritten using extensive payor suggestions. The reporter handbook, for operators reporting to the Production Accounting and Auditing System (PAAS), has also been structured to provide clear instructions.

Product value regulations for oil and gas, which establish the base value upon which royalties are calculated, have been extensively revised. A major objective of the revision has been to provide payors with more clarity and certainty in the calculation of royalty obligations. Final rules were effective March 1 for oil and gas. Coal rules are in process and should be issued before the end of 1988. The MMS has conducted extensive training sessions in many cities to help companies report and pay accurately. Most recently, several 2-day sessions were conducted around the country to help companies understand the new oil and gas product value regulations and their effect on reporting.

II. Collection and Processing

Payors are responsible for timely reporting and payment; MMS is responsible for receiving and processing payor submissions through its collections activities. The MMS has three major revenue and information collection systems:

1. The Bonus and Rental Accounting Support System (BRASS). The BRASS accounts for and distributes annual rentals from 61,000 nonproducing onshore Federal leases. This function was historically the responsibility of the Bureau of Land Management (BLM) and was transferred in FY 1983 to MMS; the new system, BRASS, became operational in FY 1984. It runs adequately on one VAX minicomputer. The system was designed under contract for MMS and was

implemented on time and within budget. It has been audited and the minor deficiencies noted were corrected.

2. The Auditing and Financial System (AFS). The AFS accounts for and distributes royalties from producing or producible Federal onshore and Indian leases and all offshore leases. Efforts began as early as 1980 to replace the outmoded Royalty Accounting System (RAS) with a new, custom-designed accounting system. The AFS became operational in 1983, after 3 years of development and testing. It soon became apparent that the volume and complexity of the workload would exceed the capability of the processing environment. Funding was sought and obtained to convert the system from the original minicomputers to a mainframe computer. After intensive study, a contract was awarded in 1985 to make this conversion. The conversion was difficult but was completed in September 1987. It was a successful conversion, however, and the system has been functioning smoothly since September. As a result of improved computer support, MMS has been able to accelerate its accounting processes, expedite royalty and interest billings, and improve on-line data access to users and royalty recipients.

   Although AFS was a vast improvement over RAS, several problems had to be resolved for the system to perform as anticipated. First, the reference information available under RAS and initially available to AFS was frequently out of date or simply incorrect and the quality of monthly reporting was poor. Initially, over 40 percent of the reported lines submitted by payors were rejected because they contained "fatal" errors or did not match reference data in the system. Correction of these errors was time-consuming and resource intensive for both payors and MMS. Consequently, distribution of cash to recipients was delayed, causing MMS to incur an interest liability under the newly enacted requirements of FOGRMA.

   A combination of initiatives was undertaken which has brought the initial input error rate down from 40 percent to less than 4 percent over the past 5 years:

   - On the payor side, MMS conducted intensive payor training, published a revised payor handbook, mailed out pre-printed monthly report forms, and assessed charges for reporting errors.
   - Internally, the entire AFS data base was validated against BLM, BIA, State, and tribal data sources. This validation effort resulted in adding 67 leases to AFS and 345 leases to BRASS to round out the lease universe, and the validation of fund distribution codes, plus county, State, and Treasury codes to assure a correct base of reference data.
   - An automated system (Interagency Data Verification System, or IDVS) was designed and implemented to compare BLM and MMS data bases on a periodic basis.

These initiatives resulted in dropping the input error rate to its lowest level of 3.02 percent in February of this year.

Another major problem was in the system design itself. The system as originally designed had little flexibility and was not "user-friendly." In 1983, Congress imposed new processing requirements with its passing of FOGRMA such as monthly distribution and reporting of collected royalties to States. In the minicomputer environment existing in 1983 and 1984 it was not possible to accommodate the new congressional direction well or completely. Finally, experience from daily operations suggested a variety of improvements that could be made.

Significant improvements to the system, however, had to be postponed until it was converted to the mainframe computer and some experience gained in that new operating environment. To address that need, a comprehensive systems improvement effort was begun in late 1986. Approximately 50 significant improvements--both computer and noncomputer related--were identified and coordinated closely with States, Indians, and industry through the Royalty Management Advisory Committee. We are currently in the process of making a variety of "short term" improvements--that is, those that can be done relatively quickly. These include improving data provided to BIA and Indian tribes, making modifications to identify and control adjustments, and eliminating zero sales reporting while implementing assessments for late and missing production reports.

The improvements that will take longer are under study to determine the best approach. We visualize that these will be implemented over the next several years. Overall, we anticipate a substantial reduction in reporting requirements on industry, improved payment performance to States and Indians, improved reporting to payment recipients, and a more efficient and user-friendly operating environment.

3. The Production Accounting and Auditing System (PAAS). Operators of leases (who often are different than all or some of the payors) report production volumes, dispositions, and inventory changes for the various products to PAAS. Information supplied to this system is compared to sales volume data supplied to AFS. Variations are noted and reviewed. If underreporting of production is detected, bills are issued and additional collections made. This system was tested during 1984 with a group of "pilot" companies and implemented in a production mode in February 1985 for offshore leases.

The PAAS has been operational for all offshore oil and gas leases (approximately 2,000), all solid mineral leases (approximately 450), and for approximately 1,300 of the 24,000 onshore oil and gas leases since 1985. Overall, this represents only 17 percent of the producing leases but over 70 percent of the royalty revenue. The system works well.

Recently, the Department decided to extend PAAS to onshore oil and gas leases. The MMS was designated the Agency responsible for collecting and distributing production data for all onshore oil and gas leases using a modified PAAS approach. This responsibility was lodged with MMS for the following reasons:

- MMS's centralized accounting structure was judged to be the most cost effective.

- MMS centralized computer facility offered the best processing environment.

- MMS provided the broadest access for users.

- MMS had the greatest need for the data, given its sales volume and production volume comparisons.

- MMS's automated comparison of sales and production data supprots both production verification and audits.

Extension of production accounting to Federal and Indian onshore oil and gas leases was mandated by FOGRMA and is consistent as well with recommendations advanced by the Linowes Commission, the Royalty Management Advisory Committee, the Department's Mineral Lease Information Study team, and other industry, State and Indian groups. As a result of this decision, an implementation plan was developed and is being implemented for software development, data base verification, operator training, and determination of State and Indian report requirements. This effort will affect about 1,800 oil and gas operators who submit over 20,000 monthly production reports.

Those companies wishing to report on the original PAAS form used for offshore production were allowed to do so, using their existing reporting systems. This conversion has just been completed and accounts for nearly 20 percent of onshore oil and gas production.

Because of the large scale of onshore oil and gas operations, most companies will be converted to the automated system in phases, using the traditional BLM reporting formats for production data. This will begin next month, with the final phase to be completed in May 1989. As a result of this initiative, MMS will be distributing onshore production data to BLM, BIA, and to States and Indian tribes receiving royalties.

III. Distribution and Explanations

Revenue collected by MMS from mineral leasing on Federal lands is disbursed to States, the general fund of the Treasury, the Windfall Profit Tax account, and a number of designated special-purpose accounts. All revenues collected from Indian leases are similarly disbursed by BIA to the appropriate Indian tribes and allottees. All disbursements formulas are established by law.

The complex process of determining proper distribution and disbursement of revenues is accomplished through AFS and BRASS. System controls monitor the status of revenues from the point of receipt to disbursement. Approximately 95 percent of collections are paid out by the end of the month following the month of receipt. The remainder need more extensive research to reconcile reporting problems and other special situations. These are usually cleared up in the next month.

Indian revenues are immediately deposited in interest-bearing accounts maintained by BIA, while royalty data is processed so that revenues can be attributed to leases and disbursed by BIA to tribes and allottees.

Before the enactment of FOGRMA, States, tribes, and allottees received no explanation of their royalty payments. The FOGRMA requires not only disbursements by the end of the month following the month in which the funds were received, but also an explanation of the source of the funds. In response, MMS supplies an Explanation of Payments (EOP) report to each recipient State, tribe, and BIA office for Indian allottees. In an effort to make the system more user-friendly and to improve its usefulness to recipients, the following initiatives have been undertaken:

-- A user-friendly, remote-access system, named "State and Tribal Support System" (STATSS) was developed. The STATSS allows recipients to access AFS data files with pre-programmed or ad hoc reports. The MMS has conducted extensive user needs and user training sessions. The STATSS is operational at remote stations for 9 States, 10 tribes, 14 BIA offices, and several other users.

-- Recipients have been trained in the functions and reports available from AFS. This training is available on an ongoing basis, as State and Indian personnel change.

-- Special interim reports have been developed where possible to meet recipient requirements.

-- The needs of recipients have been included in the system improvements project, and several enhancements to the EOP are planned.

IV. Verification

The MMS has developed several approaches to detecting and verifying that full payments have been made timely.

1. AFS Exception Processing

An important function of AFS is to detect late payments and certain types of underpayment. Implementation of this function, called exception processing, began in February 1985. Exception processing is the identification of conditions that can result in billing actions. The AFS generates billable exceptions by comparing what a payor reports and pays to what the system expects the payor to report and pay. The following exception types are identified through this process:

Royalty underpayment exceptions are created when the amount of payment received appears to be less than the royalties reported.

Late payment exceptions are generated when the payment is received after the due date.

Insufficient estimate exceptions are interest charges billed for Indian leases when the actual royalties paid 2 months after the sales month exceed the previously paid royalty estimates.

Nonrespondent exceptions are automatically identified when a payor fails to report or reports late for a particular accounting identification number, product code, or selling arrangement.

Bills are also issued for erroneous reports, but come from data manually compiled rather than from an AFS module.

The table below summarizes interest collections from our exception processing modules.

EXCEPTION PROCESSING - BILLS AND COLLECTIONS
FEBRUARY 1985 THROUGH MARCH 31, 1988
($ IN THOUSANDS)

Module	No. of Bills	Net Billings	Collected Amounts	Bonded Pending Appeal	Balance Outstanding
Federal Interest	7,486	$35,173	$25,954	$5,107	$4,112
Indian Interest	6,239	2,211	1,877	1	333
Subtotals	13,725	$37,384	$27,831	$5,108	$4,445
Federal Underpayments	339	3,800	3,494	-0-	306
Indian Underpayments	82	125	43	-0-	82
Subtotal	421	3,925	3,537	-0-	388
Nonrespondent	3,933	386	203	-0-	183
Totals	18,079	$41,695	$31,571	$5,108	$5,016 1/

2. The PAAS/AFS Comparison

As discussed previously, PAAS is an integrated system of manual procedures and automated processes for minerals production reporting, accounting, and auditing. Product reports are submitted by lease/agreement and facility operators. The PAAS is designed to track minerals from Federal and Indian leases from the source of

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1/ Of the outstanding balance, $.9 million is not yet due from payors, $2.9 million is on hold for further internal review, and the $1.2 million represents delinquent accounts being pursued for collection by MMS.

production through inventory, measurement, and processing facilities to the point of disposition, with emphasis on the point of royalty determination. The PAAS monitors dispositions such as sales, injections, flarings, and conversions to other products to ensure there is accountability for all original production.

The PAAS is designed as an extension of another MMS system, the AFS. The AFS collects and accounts for royalties owed and paid for production from Federal and Indian leases. Based on data provided on production reports, PAAS identifies the amount of production that should be reported to AFS as sold. Sales volumes reported to AFS should match those reported to PAAS. The two systems were designed so that data would be compared regularly to identify instances of underreporting, overreporting, and nonreporting. Such comparisons for offshore leases have resulted in collecting approximately $20 million in additional royalties since implementation in 1985.

3. Production Verification

The BLM is responsible for production verification for onshore oil and solid mineral leases, and MMS is responsible for offshore leases. Following is a summation of the Department's production verification activities:

- The BLM has just about doubled the number of oil and gas inpsectors since enactment of FOGRMA, from 60 to 117.

- A three-level oil and gas inspection strategy has been implemented by BLM including an on-the-ground screening of production handling and reporting, a further resolution inspection process in response to problems identified during the level one process, and finally, a detailed production verification inspection triggered by an anomaly at level one or two. Level three inspections also are performed on randomly selected leases

- The MMS Pacific Regional Office has been verifying run tickets for oil sales since January 1985 and comparing them to PAAS production reports.

- An automated system for verifying all Outer Continental Shelf (OCS) oil production is in the final design phase and implementation is scheduled for September.

- Oil and gas inspections include steps to assure that meters are not by-passed and there are no signs of theft. Additionally, OCS meter provings are regularly witnessed by MMS petroleum engineers and technicians.

- Various alternatives for verifying OCS gas volumes are presently being evaluated.

- The BLM and MMS have implemented procedures for oil and gas whereby volume discrepancies identified through BLM's production verification inspections are researched by MMS and any associated royalties are collected. This effort has resulted in almost $70,000 in additional royalties thus far.

4. Audit

Payments made to MMS are subject to audit. A 200-person audit staff compares a payor's royalty reports and payments with back-up data in company offices and information available from other sources to determine whether payments were made in full, on time, and in compliance with applicable laws, lease terms, and regulations. From inception of the royalty audit program in FY 1982 through March 1988, audit activities have resulted in additional collections of over $332 million and refund denials of over $97 million, as detailed in the table below.

MMS Audit Program Collections and Refund Denials
October 1, 1981, through March 31, 1987

Additional Collections in Millions

Federal Onshore Leases	$167
Federal offshore Leases	78
Indian Leases	12
Total Additional Royalties	257
Late Payment Charges	53
Followup - OIG Audits	21
Refund Denials	97
Liquidated Damages (0.5)	1
	172
TOTAL	$429 Million

In addition, companies have appealed hundreds of audit billings, posting $230 million in bonds or letters of credit pending resolution of their appeals.

The MMS Audit Strategy, approved and published in April of this year, describes plans for audit coverage of Federal and Indian mineral revenues. To provide this coverage, 59 resident auditors are located at the offices of the 13 largest royalty payors. Another 220 firms are covered by mobile teams of Federal, State, and Indian tribal auditors. The remaining staff focuses on the intermediate and smaller payors, targeting companies for review on the basis of referrals from other Federal, State, and Indian agencies; statistical sampling procedures; and leads developed from other audits and exception processing.

The Audit Strategy and accompanying annual Audit Work Plan evolved over the past 2 years with extensive input from State and tribal agencies participating in audits under delegated authority. In developing the Strategy and annual Audit Work Plan, we used, among other things, company and lease inventories developed from the AFS data base. Company audits already initiated generally cover the period October 1981 to September 1987 and include over 70 percent of the royalty revenues during the period. At present, we have an estimated 233 major royalty payors targeted for comprehensive company audit in the 6-year cycle and presently have company audits underway on 89 companies. Further, we have taken action to minimize or eliminate audit work on Section 10 refund requests in order to maximize the use of our audit workforce on payor compliance. For Indian leases, the Strategy is supplemented by about 25 staff years reserved for responding to lease specific audit requests, audits of nonstandard leases, and litigation support.

Audits are currently performed under FOGRMA Sections 202 and 205 delegations by the Navajo Indian Tribe and the States of Alaska, California, Colorado, Montana, North Dakota, Oklahoma, Utah, and Wyoming. In addition, cooperative agreements are in place with the State of New Mexico and the Southern Ute and Jicarilla Apache Tribes. These efforts have resulted in audit collections of $55 million or about 13 percent of the above $429 million.

V. Enforcement

The MMS has a comprehensive enforcement and penalty strategy to encourage prompt and accurate royalty reporting and payment. The tools used to carry out this strategy include (1) interest charges, (2) erroneous, late, and nonreporting assessments, and (3) civil penalties. These three different types of enforcement mechanisms result from different provisions of FOGRMA.

Interest charges are mandated by Section 111 of FOGRMA. They are intended to compensate the U.S. Treasury for the loss of revenue resulting from late receipt of monies.

Reporting assessments are a charge which varies from $3 to $10 for each line of data reported incorrectly or late, or not reported at all, on Form MMS-2014, the Monthly Report of Sales and Royalty Remittance. These assessments are authorized by Section 101 of FOGRMA, as implemented by 30 CFR 218.56.

Civil penalties are the enforcement action of last resort. By law, civil penalties cannot be imposed until a payor has been provided an opportunity to correct the violation to be penalized. The process begins with a demand letter or bill for collection. If this is not satisfied, a Notice of Noncompliance is issued, explaining the violation and the remedies expected. The payor is provided 20 days from the date of service of the Notice to correct the violation. If this is not done, the civil penalty goes into effect. The payor is then expected to correct the violation and pay the penalty. The penalty continues to run, at a specified rate per day, until the maximum penalty is reached or the underlying violation is corrected, whichever happens first.

The first Notice of Noncompliance was issued September 29, 1984. To date, MMS has issued a Notice of Noncompliance and Civil Penalty in 30 cases. The status of these 30 cases is summarized below.

Issued	Status	Penalty Amount (Through 5/88)
13	Corrected violation before penalties accrued.	-0-
7	Corrected violation and paid penalties.	$63,463
5	Corrected violation, penalty not yet collected.	$977,707
2	Violation not corrected and penalty owed (to be referred to the U.S. Department of Justice).	$240,000
2	Violation not corrected and penalty accruing; company has requested hearing on the record.	$202,560
1	Decision by the Department, Office of Hearings and Appeals upheld MMS; company is appealing. Penalty not yet collected.	$20,440,000

In addition to the 30 cases, another 12 violators who were contacted by telephone and encouraged to correct their respective violations before MMS mailed the written Notice of Noncompliance and civil penalty letter did so before the Notice was issued.

When Royalty Management issues enforcement actions for the collection of additional royalties, or for assessments of late and erroneous reporting or civil penalties, there is a process by which these enforcement actions can be appealed to higher officials in the Department: first, to the Director of MMS, and second, to the Interior Board of Land Appeals (IBLA).

From 1975 through 1982, there were on average about 35 to 45 enforcement actions appealed to the Director of the Geological Survey each year. In 1983, there were 46 appeals to the Director of MMS. There were 80 appeals in 1984, 350 appeals in 1985, 590 in 1986 and 428 in 1987.

At present,there are 142 MMS decisions under appeal to IBLA. They deal with the following general issues:

Issues	Approximate No. of Appeals
Valuation issues	60
Late payment charges	40
Section 10 - Two Year Statute of Limitations	15
Untimely filing of notice of appeal	5
Assessments for late and erroneous reporting	10
Transportation allowances	10
Civil Penalties	2
	142

We believe these MMS and IBLA statistics clearly reflect the expanded and more vigorous enforcement program undertaken by MMS.

The Department is also in litigation with royalty payors over several royalty valuation and payment issues. A royalty payor may seek judicial review of final departmental enforcement actions in Federal District Court. The following is a list of significant royalty issues now in court:

-- Royalties on Take-or-Pay Revenues

Many gas purchase contracts require purchase of a minimum volume of gas, or payment for that amount even if the required minimum is not taken in full. The MMS maintains that royalty is due when the producer receives payment because it is a part of the lessee's "gross proceeds," while payors maintain royalty is due if and when "make up" volumes are actually taken. The Department is in litigation over this issue in consolidated cases in the Fifth Circuit and in lower courts and in several pending administrative appeals.

-- Gross Proceeds

When a royalty payor receives payments such as reimbursements for State severance taxes or payments for various production-related costs under NGPA section 110 and FERC Order 94, MMS assesses royalty on these payments as part of the lessee's "gross proceeds," i.e., the total consideration paid for purchase of the product. Several payors are alleging that these payments are not consideration for production and, therefore, not part of royalty value. These claims are in litigation in several Federal courts and administrative appeals.

-- Product Value Regulations

One lawsuit is now pending involving industry challenges to several aspects of MMS's recently promulgated oil and gas product value regulations.

-- Value of Royalty Oil Taken In-Kind

Mineral leasing laws allow MMS to take the Government's royalty share either in value or in-kind. Historically, MMS has taken much of its oil royalties in-kind. Many purchasers alleged MMS charged more for the oil during the early 1980's than was authorized by price control regulations of the Department of Energy. The Department has prevailed on sovereign immunity and jurisdictional grounds in two appeals, and the Supreme Court has recently declined review in all of these cases.

-- Coal Royalty Rate Readjustment

The Federal Coal Leasing Amendments Act of 1976 (FCLAA) requires a royalty on coal mined by surface methods to be 12.5 percent of value while leaving the rate for coal mined by underground methods left to the Secretary's discretion. Royalty for coal production for leases issued prior to 1976 were generally based on a specified amount per ton of coal produced. The BLM readjusts lease terms for all Federal coal leases every 20 years after the initial 20-year term. The BLM has modified the royalty provisions in these older leases when they come due for readjustment and has imposed the ad valorem royalty rates established under FCLAA. Many holders of coal leases have contested this practice and have sued the Department in Federal Court. The Tenth Circuit affirmed the BLM's readjustment of the royalty rates although it remanded the underground rate readjustments for further consideration under a departmental rule requiring a lower underground rate "if conditions warrant." The Supreme Court denied review of this decision. The BLM reconsideration of the proper underground rate is ongoing. The MMS also has litigation in District Court over the proper valuation method for the coal production.

-- Refunds Pursuant to the Outer Continental Shelf Lands Act (OCSLA)

Payors on offshore leases sold gas at maximum permissible prices which later were retroactively reduced as a result of legal action. The offshore producers were required to make refunds to their pipeline purchasers and accordingly sought royalty refunds from MMS. Pursuant to section 10 of OCSLA, MMS denied refunds of royalties paid more than 2 years prior to the filing of the refund request. The lessees contend that section 10 requires them to file a refund within 2 years after the payment became an overpayment. The Department is litigating this issue in several cases before the Claims Court.

-- Valuation Issues - Royalty Due on Indian Leases

The Department has pursued litigation in several cases for collection of additional royalties for natural gas production from Indian leases, involving various valuation issues.

-- Nonpayment of Royalties in Bankruptcy Proceedings

The MMS is pursuing over 25 cases of underpayment or nonpayment of royalties by companies which have filed for bankruptcy under Federal law.

-- Gas Valuation in the Kenai Field in Alaska

The MMS has been pursuing underpayment of royalties for gas produced from the Kenai Field in Alaska. A large portion of these royalties is paid to Cook Inlet Region, Inc., an Alaska Native Corporation, which acquired major interests in the Federal leases under statutory provisions settling Alaska Native claims. In 1985, the Department reached an out of court settlement with Union Oil Corp. regarding its interest. The MMS won its case against Marathon Oil Corp. regarding liquefied natural gas valuation in both the District Court and the Ninth Circuit Court of Appeals, and has been pursuing resolution of the specific accounting procedures to be used, as well as valuation of gas rented for use in other fields.

-- Civil Penalties

The FOGRMA authorizes MMS to collect various civil penalties for violations of mineral leasing laws, orders, or lease terms. Several penalty cases are now pending before Federal district courts.

Conclusion

I hope this information demonstrates that the Department has made significant improvements in the performance of its Royalty Management function over the last few years. During the past year, we have accomplished or have underway several significant actions:

1. The AFS became operational on a mainframe computer. As mentioned earlier, this allows us to do our work more efficiently and better serve the system's internal and external users. A major systems improvement project is now underway, utilizing user comments to plan and schedule enhancements to the system.

2. Oil and gas product value regulations were published as final rules on January 15, 1988, culminating 5 years of analysis and consultation with interested parties. Coal regulations are in process, also using extensive consultation, and should be issued as final rules by the end of 1988.

3. In December, Congress passed H.R. 3479, the "Notice to Lessees Numbered 5 Gas Royalty Act of 1987" (NTL-5) to clarify payment requirements for onshore gas leases. The Department published a notice in the Federal Register on February 25, 1988, explaining provisions of the Act and providing a description of the procedures the Department will use to collect underpayments or issue refunds which result from royalty calculations under the Act. I wish to thank the Chairman and members of the Subcommittee for their leadership and support on the NTL-5 issue.

4. Payor training sessions covering the new oil and gas rules and NTL-5 began in February. To date, 1,200 Indian, State, and industry personnel have attended the 11 sessions conducted throughout the country.

5. A number of activities during the past year contributed to improved royalty management services to Indian royalty recipients. The Audit Strategy and Annual Audit Plans have been revised to provide improved audit coverage of Indian leases. Work has begun to convert Indian leases to PAAS. Systems improvements are underway which will improve the quality of reports being provided to accompany revenue distributions. And finally, MMS has agreed to assume responsibility for accounting for revenues from nonstandard Indian leases and agreements.

6. Work continues on commitments made in the Department's 1985 Management Action Plan for Royalty Management. At this time, 27 action elements have been completed, 5 elements have been set aside after further study, 1 is on hold, and the remaining 9 elements

are substantially underway.

All these accomplishments notwithstanding, the Royalty Management Program still draws critical publicity from time to time. You are undoubtedly familiar with the Arizona Republic series of articles which criticized the Department's management of Indian affairs, and included commentary on minerals and royalty management issues. As a consequence, the Senate Select Committee on Indian Affairs began an investigation inquiring into the Department's fulfillment of its trust responsibilities to Indians, including the royalty management mission. I believe, however, that MMS should receive a passing grade from this investigation, and I would like to submit for the record at this time my detailed response to the Arizona Republic as well as a similar response to a series of articles which appeared in the Tulsa Tribune. Our conclusion was that much of the information in these articles was dated, wrong, or taken out of context.

The Subcommittee is well aware that Congress has shown keen interest in the activities of the Royalty Management Program through numerous site visits, oversight hearings, and staff investigations. Additionally, the General Accounting Office (GAO), the Department's Office of Inspector General (OIG), and other external audit groups and observers have also conducted oversight of RMP. The Congress, GAO, OIG and other oversight groups have made numerous positive recommendations concerning the Program. In response, we have either implemented or moved to implement most of the recommendations made by these groups. I think the fact that we have made such substantial progress is evidenced in the favorable statements made by both the GAO and a member of this Senate. In April 1987, the GAO testified before a House Subcommittee that the Department had made "noteworthy progress" in resolving past problems. After reviewing the record, Senator William Proxmire praised our efforts late last year, stating that the Interior Department "deserves a pat on the back for beginning to do a difficult job well."

I believe the above list of Royalty Management Program achievements during the past year is one to be proud of, and I am confident that we will continue to make improvements to this complex and challenging program.

Mr. Chairman, this completes my prepared statement. I would be pleased to answer any questions you or the Subcommittee members may have.

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
WASHINGTON, DC 20240

DEC 24 1987

Mr. Jenkin Lloyd Jones, Sr.
Editor
The Tulsa Tribune
P.O. Box 1770
Tulsa, Oklahoma 74102

Dear Mr. Jones:

In response to your recent series, "A Vanishing Trust" (November 9-18, 1987), I commend you for a generally balanced presentation of information about the Minerals Management Service (MMS) and its royalty management program. Still, some of the conclusions you draw are troubling, and I offer some observations about those.

You reported that royalty management by the Interior Department not only has failed to improve in recent years but has gotten worse. In fact, the royalty management program has enjoyed tremendous improvement since 1982, when MMS was created to take it over. The program has won praise from the General Accounting Office (GAO), which testified before Congress in April 1987 that the Department has made "noteworthy progress" in resolving past problems; and from Senator William Proxmire, who stated recently that the Interior Department "deserves a pat on the back for beginning to do a difficult job well."

You also reported that "underpayments are staggering." I think you misunderstand the terms "underpayment" and "undercollection." An underpayment is the difference between the amount initially paid by a lessee and the amount truly owed. It is subject to discovery through audits and other detection techniques built into our accounting system, and it is subject, of course, to collection with interest. An undercollection is the difference between the amount finally collected and the amount owed. Undercollections are losses of income, but underpayments reflect only a delay in income. Some of the estimates you cited as lost revenue and uncollected royalties were actually estimates of underpayments, and the one put forward in a House Appropriations Committee staff report was far off the mark.

Thank you for the opportunity to clarify these points for your readers. Enclosed you will find a more detailed, point-by-point response to your series' coverage of MMS. I hope this information will be helpful to you in future reporting on the MMS royalty management program.

Sincerely,

(SGD) WM. D. BETTENBERG

Director

Enclosure

RESPONSE TO THE TULSA TRIBUNE ARTICLES OF NOVEMBER 9-18, 1987

Adequacy of Accounting System

Assertions:

"Although it has spent most of this century as steward over federal and Indian lands, the U.S. Department of the Interior has not created a system that adequately accounts for billions of dollars in mineral payments."

"Organization of the MMS to audit and collect funds was one result of the act. An explanation of payment to states and Indians was ordered.

"But things did not improve. In fact, they got worse."

Response:

The Department of the Interior (Department) has acknowledged that insufficient attention had been paid to the collection of mineral revenues during the 1970's. Over the past 6 to 8 years, however, the Department has taken a number of major actions to correct this situation and to improve the "royalty management program."

The Department's initial efforts to design and develop an improved royalty system began in 1979, following years of criticism focusing on the inadequacies of the U.S. Geological Survey (USGS) Royalty Accounting System (RAS). A Task Force report and subsequent policy paper formed the basis for design and development of the replacement systems used by the Minerals Management Service (MMS) Royalty Management Program (RMP) today. These systems are the Auditing and Financial System (AFS) and the Production Accounting and Auditing System (PAAS). Five years of implementation experience has identified the following significant improvements over RAS:

- Centralization of policy formulation and accounting functions.
- Provision for the first time of detailed royalty-related information to States, Indian tribes, and industry.
- Automated processing of financial and production accounting data by a modern computerized system.
- More efficient and timely disbursement of monies to recipients.

In 1985, Secretary Hodel reviewed the work that had been done and the problems which remained to be solved, and issued a Management Action Plan for RMP which laid out plans and time tables to deal with the further concerns of recipients, external review groups, and others. As a result, several specific actions were taken to improve services to Indians. They include:

- Creation of the MMS Office of External Affairs to provide outreach to Indians.

- Creation of the Office of State and Tribal Program Support within the MMS Royalty Compliance Division to provide guidance and assistance to Indian tribes with cooperative and delegated audit agreements.

- Approval of a Memorandum of Understanding between MMS and the Bureau of Indian Affairs (BIA) to define the responsibilities of each agency and to establish a BIA/MMS Joint Steering Committee which meets quarterly to resolve problems and issues affecting Indian royalty management.

- Development and implementation of an Indian Lease Audit Strategy to expedite audit requests, provide information to Indian allottees on the status of audits, maximize audit resources, and identify future audit targets.

- Design and implementation of the State and Tribal Support System (STATSS) to provide Indian tribes and BIA offices with access to data contained in the AFS data bases.

Simultaneous with these initiatives, MMS was working diligently in less visible areas to improve royalty management. Accomplishments include implementing a major audit program, including cooperative audits with States and tribes; training payors to report and pay timely and accurately to the new accounting systems; developing better reports for royalty recipients; writing regulations to implement the legislation and improve compliance; and contracting to improve computer support.

The result of these efforts is that while we have not solved all our problems, the management of royalty revenues is greatly improved. The General Accounting Office (GAO) and the Department's Office of Inspector General (OIG) are both auditing the MMS RMP on a continual basis, but their reports now concern mostly smaller-focus operational issues, rather than the program-wide failures that were documented in previous years. In fact, during a hearing in April 1987, GAO Associate Director John Simonette testified that, "I think in fairness to the Department that there has been noteworthy progress made." In addition, in the September 29, 1987, Congressional Record, Senator Proxmire concluded about royalty management that " . . . the Department was no longer at fault. Instead of a lashing, they deserve a pat on the back for beginning to do a difficult job well." Senator Proxmire also asserted that, "Given the complexities of [the] system, the Department is doing a reasonably good job. A little more time to continue their improvements and they may soon be doing an outstanding one."

Underpayments

Assertions:

"By the most conservative of estimates, underpayments are staggering.
"John Simonette, an official with the General Accounting Office which monitors federal programs, told a congressional hearing in April that uncollected royalties 'probably run in the several hundred million dollar range.'"

"But the Minerals Management Service can do anywhere from $300 million to $1 billion a year better, its critics insist."

"Rep. Sidney Yates, D-Ill., chairman of the House Appropriations Committee, lashed out at MMS during a congressional hearing a year ago.
"'I must tell you in utter candor and frankness, I am just appalled by what is happening in MMS; not just by what is happening, but by what is not happening,' he told Bettenberg.
"Yates brandished an investigative report by staff members who examined leases and underpayments in four Western states. They concluded underpayments averaged 21 percent.
"The staff estimated MMS collections could be short by as much as $5.8 billion since 1979 if applied to all states.
"Bettenberg later scoffed at the figures, saying revenues lost were approximately 3 percent. He did not pinpoint a dollar loss but retorted 'our auditors say it can't be anything like that.'
"He charged that Yates could not back up his 'flawed information' from such a limited review and termed any billion-dollar price tag 'laughable.'"

Response:

Assertions that millions or billions of dollars are being underpaid to MMS arose from a statement contained in a report released in September 1986 by the House Appropriations Subcommittee on Interior and Related Agencies.

The Subcommittee's report projects (but does not "claim" or "find") aggregate undercollections of 21 percent based upon audit findings which yielded additional billings totaling 21 percent. The MMS warned both the authors and readers of the Subcommittee's report that these audit statistics could not be projected to the universe of leases and payments for the following reasons:

- The MMS audit sample was limited to leases on which there were underpayments. Leases on which royalties were properly paid or overpaid were not included.
- The MMS auditors concentrate on leases, time periods, and circumstances where underpayments are most likely to occur. Results from those audits cannot be extrapolated to the universe of leases and payments.
- Many of the audit findings were based on MMS interpretations of complex issues, which the payor is appealing or litigating, and which may ultimately be decided in favor of the payor.

- Perhaps of greatest importance, the audits covered periods back as far as 1978, well before the improvements in royalty collection and compliance of the past few years.

For similar reasons, Senator Proxmire has stated in the Congressional Record that, "The only thing wrong with this number is that it is based on analysis so faulty that a freshman statistics student would receive a big, fat 'F' if he handed it in."

It may help to explain that there is a difference between:

underpayments - the difference between the amount initially paid and the amount owed, and

undercollections - the difference between the amount finally collected after MMS audits and the amount owed.

As thus defined, undercollections are a true loss of income; but underpayments may only reflect a delay in income--for which we are compensated by interest assessments.

We have never denied that initial underpayments exist. Just as with the Internal Revenue Service, it is not possible to collect all revenues "up front" when initial payments are based on voluntary compliance. Although we expect lessees to comply in good faith with applicable laws, regulations, and lease terms, we have differences of opinion as to what compliance requires.

These differences will not all be resolved until administrative and legal appeals are exhausted--a process that will take years. However, many will be resolved more directly in our proposed product value regulations and in litigation that may ensue on those regulations.

We believe the safeguards are in place to ensure that ultimate undercollections are minimized. That is why we have created a 200-person audit staff over the last 5 years to regularly audit payors and why we routinely check to see that payments are made on time and for all producing leases.

Regarding Mr. Simonette's comment during a Congressional hearing that underpayments (not uncollected royalties as cited in the Tulsa Tribune) "probably run in the several hundred million dollar range," it is important to note that he stated that, "we have not been able to precisely define or identify what the magnitude of those underpayments are," and that MMS has a system to detect and collect underpayments.

The statement in the Tulsa Tribune that "Bettenberg later scoffed at the figures, saying revenues lost were approximately 3 percent," (emphasis added) obviously arose from the author's misunderstanding of the difference between underpayments and undercollections. Mr. Bettenberg was referring to the amount that MMS estimates is due prior to audit and which will be recovered with interest after audit. He did not imply that 3 percent of the royalties due go uncollected and are therefore lost.

Honor System

Assertions:

"States are no happier with the MMS acting as the auditor.

"They cannot cross-check the amount paid by an energy company against the amount actually produced from leases onshore.

"'It is still the honor system because you can't match a check to a production report,' asserted Valdean Severson of the Wyoming state auditor's office."

Response:

The MMS AFS is operated similarly to income tax reporting under the Internal Revenue Service. Those who owe royalties are expected to report and pay the correct amount due to the Federal Government. But just as with the Internal Revenue Service, MMS's collection and verification efforts do not stop at that point.

Because we anticipated that there would be discrepancies and delays in payment and reporting, we have implemented several approaches to detecting and verifying that full payment has been accurately identified and made. These approaches include:

- Audits. Payments made to MMS are subject to audit. The MMS royalty audit program is implemented by the Royalty Compliance Division (RCD) and by State and Indian tribal auditors working with MMS under delegated agreements and cooperative agreements. The RCD audit resources are available from 13 resident audit teams and 19 mobile teams. Audit collections and refund denials total more than $387 million from program inception in October 1981 through August 1987.

- AFS Exception Processing. A function of the AFS, MMS's computerized royalty accounting system, is to detect late payments and certain types of underpayment. Exception processing is the identification of conditions that result in billing actions. The AFS generates billable exceptions by comparing what a payor reports and pays to what the system expects the payor to report and pay. Exception processing has been operational since February 1985 and has brought in additional collections of almost $20 million through August 1987.

- PAAS/AFS Comparison. The PAAS is an integrated system of manual procedures and automated processes for minerals production reporting, accounting, and auditing. The PAAS is designed as an extension of AFS which collects and accounts for royalties owed and paid for production from Federal and Indian leases. Based on data provided on production reports, PAAS identifies the amount of production that should be reported to AFS as sold. Sales volumes reported to AFS should match those reported to PAAS. The two systems were designed so that data would be compared regularly to identify instances of underreporting, overreporting, and nonreporting. Such comparisons have resulted in the collection of approximately $14.8 million in additional royalties from April 1985 through August 1986.

Presently, PAAS is operational for offshore oil and gas, onshore solid minerals, and a limited number of onshore Federal and Indian oil and gas leases. The MMS has now been assigned the job of developing a system for the receipt, entry, edit/error correction, and distribution of onshore production data. As a result of this decision, an implementation plan was developed which includes software development, database verification, contractor hiring and training, operator training, and the determination of State and Indian report requirements. Because of the large scale of onshore oil and gas operations, automation of production data will occur in a phased manner with timing dependent on availability of funding and other considerations.

In addition to these efforts, MMS has a comprehensive enforcement and penalty strategy to encourage prompt and accurate royalty reporting and payment. The tools used to carry out this strategy include (1) interest charges, (2) erroneous, late, and nonreporting assessments, and (3) civil penalties.

Production Accounting

Assertions:

"Bettenberg announced a connecting program would be phased in between March and September 1988, but recently placed it on hold due to a lack of funding.

"Critics saw it as more of the same unfulfilled promises.

"'Matching up production with what is paid is the first step in basic accounting,' Wyoming's Severson said. 'I would say when you haven't done that for five years, you're a little late already.'"

Response:

These comments refer to delays in implementing PAAS for onshore oil and gas leases. As stated above, PAAS is presently operational for offshore oil and gas, onshore solid minerals, and a limited number of onshore Federal and Indian oil and gas leases. Conversion of the remaining onshore leases was suspended after considerable concern about the cost-effectiveness, complexities, and need for PAAS by industry and congressional committees. Specifically, the House Committee on Interior and Insular Affairs in its December 1984 report on Federal Minerals Royalty Management recommended that implementation of PAAS onshore be delayed and the requirements be restudied to determine if a simpler and less costly alternative could be found. (Consultation with Mr. Severson's supervisors during the Summer of 1985 confirmed that they considered onshore PAAS conversion to be relatively low priority compared to several other initiatives then underway to improve royalty management operations.)

Because of this concern, a Department study team undertook and completed a 1-year feasibility analysis of PAAS. The report analyzed 21 alternatives to production accounting for onshore oil and gas leases. Additionally, the Royalty Management Advisory Committee appointed a panel to study whether PAAS should undertake the remaining onshore conversion. Among its recommendations was the proposal that BLM Form 3160-6 (3160-6), the existing onshore production reporting form, be converted to an automated reporting system and that PAAS not be further implemented onshore. The Committee tabled the recommendation, and the Assistant Secretary - Land and Minerals Management appointed a team to study four additional alternatives to reporting and to enabling a production/sales comparison.

Based on the report of the task group and other studies, the Assistant Secretary - Land and Minerals Management decided that MMS will computerize data submitted on a slightly modified version of the 3160-6. The MMS will be responsible for receipt and edit/error correction of the 3160-6, as well as distribution of the production data to BLM, States, tribes, and BIA. As stated earlier, automation of production data will occur in a phased manner with timing dependent on availability of funding and other considerations.

Production Information

Assertions:

"What is termed 'production' information on the form rankles states and tribes. It lists production only after minerals are sold, not what comes out of the ground.

"'They've argued that production means reported sales. Well, that's just nonsense,' Taradash said. 'That's not at all what the law requires.'"

"Bettenberg argues his agency is technically in compliance with the law by providing a production figure.

"'We do provide them with a number but the number isn't really the relevant one all the time. We need to do better than that.'"

Response:

The MMS provides production information in the form of production sold on the explanation of payment report provided to States, Indian tribes, and BIA for its use in providing explanation of payment information to Indian allottees. This is the quantity on which royalty is paid and, therefore, the most relevant production number. Once onshore production information is reported to MMS on Form 3160-6, MMS plans to provide this additional production information to States, Indian tribes, and BIA.

Royalty Information

Assertions:

"In addition, a production figure may be a composite of several different numbers rolled into one.

"Accountant Valdean Severson of the Wyoming state auditor's office said a manufacturing allowance on gas, transportation on gas, and taxes may be rolled into one number, making audits impossible.

"'They are supposed to break it out line by line to tell you what happened on the lease,' Severson said."

Response:

We do not understand Mr. Severson's statement regarding audit impossibility. It is the function of an audit to verify that appropriate allowances are being taken. The fact that a company aggregates allowance information on a royalty report does not make the audit impossible. However, it does require an examination of the company's books and records to determine where such aggretations occur and whether the amounts claimed are appropriate. This is what MMS auditors do and what Mr. Severson's State has contracted to do.

Regarding Mr. Severson's comment about line-by-line data, the State of Wyoming (Wyoming), as well as eight other States, nine Indian tribes and 14 BIA offices, has been given access to detailed information through the State and Tribal Support System (STATSS). This system was implemented on April 30, 1986. It provides access to line-by-line Auditing and Financial System (AFS) data via terminals and remote personal computers through a series of online computer screens and financial reports. Wyoming was given access to STATSS in April 1986 and has been an active user of the system.

October Indian Allottee Royalty Payment

Assertions:

"Royalty checks in October arrived late for Indians across the country.

"MMS sent the money to BIA's Albuquerque repository Oct. 19, three days late. Then, the BIA had problems getting the money out to area agencies.

"Sam Wilson, spokesman from the MMS Lakewood, Colo., office, said the checks were sent out on a Monday instead of a Friday because of some problems with a new computer.

"'They didn't consider that as late,' he said."

Response:

We disagree with the statement that MMS was 3 days late sending money to BIA's Albuquerque office. The MMS notifies BIA of royalties received at MMS within 24 hours of receipt. At that time, the royalties are available to BIA for investment. The MMS then provides distribution information via computer tape to BIA twice each month. The BIA processes the information and determines the amounts to be disbursed to each Indian allottee. Although the MMS distribution tape is transmitted at mid-month and month-end, the date of the mid-month transmission varies each month depending upon workload and computer scheduling. The following list depicts the dates MMS sent the mid-month tape from January 1987 through November 1987:

Month	Date Mid-Month Financial Distribution Report Tape Transmitted to BIA
Jan	1/15/87
Feb	2/20/87
Mar	3/19/87
Apr	4/16/87
May	5/14/87
Jun	6/18/87
Jul	7/16/87
Aug	8/20/87
Sep	9/17/87
Oct	10/19/87
Nov	11/19/87

As this list shows, monthly distribution tape dates vary from month to month. The October tape was originally scheduled to be transmitted on October 16. However, as a result of a problem we discovered on October 13 with software recently converted to the new IBM computer, we decided to transmit the tape on Monday, October 19 instead of Friday, October 16. This resulted in a delay of 1 business day.

Computer Costs

Assertions:

"After adding a roomful of mini-computers to expand the computer capacity at a cost of $50 million, another $32 million was spent on a larger IBM mainframe."

Response:

We disagree with the computer costs cited in the Tulsa Tribune article. The $50 million cost cited for the mini-computers includes operations and maintenance costs dating back to Fiscal Year (FY) 1981 for three separate RMP systems, which would have been incurred regardless of the computer system originally chosen. Also, while costs associated with the new computer were estimated at $32 million, actual costs were about $23.6 million for new mainframe computer hardware, conversion of the AFS, and operations and maintenance costs. Had the RMP systems originally been implemented on a mainframe computer instead of VAX minicomputers, the primary cost savings to the government would have been $4.3 million for VAX hardware and $4.2 million for conversion, a total of $8.5 million. Most of the other costs would have been incurred in either case.

Product Value Guidelines - Statements by Jerry Hill

Assertions:

"MMS is bracing for protests from states and tribes on the new guidelines.

"'They are concerned their money will drop and that is legitimate,' said MMS Lakewood director Jerry Hill.

"'But we don't see our charge as one to maximize income.

"'If you get the money now and then industry reaches its economic limit, you get less money overall.'"

Response:

Mr. Hill's comment that, ". . . we don't see our charge as one to maximize income," appears to be taken out of context. Mr. Hill commented that, in the context of product value regulations, MMS does not believe it should maximize income in the short term at the expense of long term income. It is MMS's policy to require companies to pay the full amount of royalties due under the lease terms and regulations.

Audit Collections by the State of Wyoming

Assertions:

"Wyoming officials have identified $32 million in underpayments for that same time period." [1981 through 1986]

Response:

Since inception of the joint audit program through September 30, 1987, Wyoming has collected about $25.8 million in "underpayments" and $6.7 million in interest charges, for a total of $32.5 million. They are doing a good job; that is what MMS pays them to do under their delegated audit agreement.

Audits by the State of Oklahoma

Assertions:

"Oklahoma never had audited federal leases until it began a three-year audit cycle of the 560 now producing. It has a cooperative arrangement with MMS which provides funds and reviews the results.

"So far, state auditors have identified $1.2 million in underpayments after auditing one-quarter of the leases. Most of the underpayments are from gas companies."

Response:

Research of our records shows that the State of Oklahoma (Oklahoma) has audited 28 Federal leases and identified findings of about $500,000. An Oklahoma representative informed us the $1.2 million represents findings on State and Federal leases. Oklahoma does not audit Indian leases; these are audited by MMS.

Berdena Holder

Assertions:

"'She [Berdena Holder] has brought audit situations to our attention where we found more money was owed. There are also situations where she's gotten confused. I can certify that she is not always right,' said William Bettenberg, head of the U.S. Minerals Management Service which audits royalty accounts."

Response:

Ms. Holder owns a royalty interest in three leases. The MMS has performed audits and desk reviews responding to Ms. Holder's questions relative to each of her leases and, in some cases, additional royalties were due.

During a July 1986 meeting of the Royalty Management Advisory Committee, Ms. Holder publicly claimed that her royalty payments were not timely and asked questions about her payments. Review of this matter by MMS disclosed that the royalty payments in question were paid timely. These findings were discussed with Ms. Holder by MMS representatives and were formalized in a written response to her from the Director, MMS, dated September 9, 1986.

Ms. Holder has also raised questions on behalf of other allottees which have sometimes led to collections of additional royalties.

Eddie Jacobs

Assertions:

"Eddie Jacobs of Oklahoma City is a board member who has received more than $20,000 in underpayments from energy companies after he insisted MMS audit the leases."

Response:

MMS audited four leases belonging to Mr. Jacobs. These audits resulted in underpayment and interest collections totaling $21,349. Mr. Jacobs requested the audits through BIA, which is the standard procedure used by allottees as established in the BIA/MMS Indian Lease Audit Strategy. Under the Audit

Strategy, BIA acts as the central point of contact for Indian tribes' and allottees' inquiries on their mineral rental and royalty payments. The BIA then attempts to resolve the inquiries through research and review of available information in its records/systems. Unresolved inquiries are forwarded to MMS for resolution through records research or audit.

Thomas Wahnee

Assertions:

"Thomas Wahnee, a Comanche from Fletcher, wanted to check his oil and gas lease payments in 1984.

"He was refused access to his own records unless he paid a search fee which he was told 'will probably exceed $1,000' to the Minerals Management Service, the government agency entrusted by law with keeping those records for him. The fee was reduced to $500 when his lawyer appealed.

"Following pressure by U.S. Rep. Mike Synar, D-2nd District, an audit was conducted and completed in May 1986 identifying $41,000 in underpayments and $15,000 in late payments by the oil company to Wahnee and his uncle. That money was sent to the BIA to distribute in January of this year, but Wahnee still has not been paid.

"More than three years after his inquiry, the money is being withheld while the oil company appeals the audit results."

Response:

The MMS maintains royalty payment information by payor and lease for Federal and Indian leases. It does not have information by individual Indian allottee. The MMS sends detailed lease information to BIA, which distributes the royalty payments and maintains individual allottee records. Production information for onshore Federal and Indian oil and gas leases is currently collected by BLM.

Thomas Wahnee's lawyer, Gregory Gore, contacted MMS by letter dated August 31, 1984, asking for, in part, ". . . any and all documents or records concerning the aforementioned lease and oil and gas well including but not limited to royalties paid to Mr. Wahnee since the date of the lease and all production information furnished to MMS or the USGS by unit operators, payors, lessees, assignees or any other person or entity concerning production for which he receives royalties from the date of his lease." Mr. Gore requested this information under the Freedom of Information Act (FOIA) and the Privacy Act and requested a fee waiver.

The MMS did not apply the Privacy Act to this request because that Act pertains to information retrievable by an individual's name or similar identifier, which MMS does not have. Under FOIA, MMS must charge user fees for document searches, clerical assistance, and copying costs incurred in responding to the request. The MMS responded to the Wahnee request on September 20, 1984, and informed Mr. Gore that the cost of the search would approximate $1,000. The lawyer wrote again with additional information to assist in the search and again requested a waiver of fees. The MMS response advised that he was not entitled to a fee waiver and reduced the estimated cost of the search to $500 because of the additional information provided.

On November 26, 1984, Mr. Gore filed a FOIA and Privacy Act appeal of MMS's fee waiver denial. The Department Solicitor determined that a fee waiver was not appropriate but suggested that MMS try to narrow the scope of the request in order to reduce the search costs. The Department informed Mr. Gore in April 1985 that his fee waiver appeal was denied, and MMS followed up with a letter asking for information to further narrow the request. No additional information has been requested.

The MMS audited two leases in which Mr. Wahnee owns a royalty interest for the period July 1982 through February 1984. The audits were requested by BIA on behalf of Mr. Wahnee. They disclosed that gas royalties were undervalued, and an additional $41,308 in royalties was due. The MMS collected the additional royalties plus late payment charges of $15,581. These funds were distributed to BIA in January 1987. The payor subsequently appealed both billings. The BIA escrowed these funds awaiting a decision on the appeals.

Mary Limpy

Assertions:

"Mary Limpy, a Cheyenne-Arapaho whose royalty payments dramatically decreased in 1983, filed suit in federal court with other Oklahoma Indians in 1985 asking for timely checks and an explanation of the payment.

"She and her three children were evicted from their apartment four times and set up housekeeping in a van, according to a lawsuit filed in the U.S. court, western district of Oklahoma.

"Her story was told before a congressional subcommittee in April 1985.

"'Right now she doesn't even have a van to live in,' her lawyer testified. 'She lost it to a garage when she couldn't afford to pay the bill.'

"Yet, for the five months prior to the hearings, the gas well in which she held an interest had conservatively grossed $247,000."

Response:

Audits of four leases in which Mary Limpy holds an interest, as well as other audits, were initiated as a result of a civil action (David Kauley, Mary Limpy, and Thelma Haag vs. The United States of America and William P. Clark as the Secretary of the Interior) filed December 14, 1984, in the United States District Court for the Western District of Oklahoma. This civil action is still in process.

Royalty collections for the four leases for the 6-year period ending October 1985 were $784,241, of which Ms. Limpy's share was $381,331. The MMS audits for these leases covered the same 6-year period and resulted in additional royalty collections and interest, of which Ms. Limpy's share was $77,213 and $17,727, respectively. A review of MMS records shows that royalty and audit collections for the 6-year period were transfered to BIA. We are advised by the BIA that Ms. Limpy was paid her share of all monies transfered to BIA.

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
WASHINGTON, DC 20240

DEC 14 1987

Note

To: Mr. Alan Moyer
Managing Editor
The Arizona Republic

From: William D. Bettenberg, Director, Minerals Management Service

Enclosed is my response to your series of articles entitled "Fraud in Indian Country: A Billion-Dollar Betrayal." In the event that you choose not to print my detailed reply, I have included a shorter response.

Wm D Bettenberg

2 Enclosures

United States Department of the Interior
MINERALS MANAGEMENT SERVICE
WASHINGTON, DC 20240

DEC 14 1987

Mr. Alan Moyer
Managing Editor
The Arizona Republic
120 East Van Buren
Phoenix, Arizona 85004

Dear Mr. Moyer:

In your series, "Fraud in Indian Country: A Billion-Dollar Betrayal" (October 1987), you make many false and misleading statements about the collection and management of Indian mineral royalties. Despite our efforts to provide your reporters with sound, documented information on the Minerals Management Service (MMS) and its royalty management program, they elected to rely on unsupportable "data" and ill-informed sources, and misused conclusions and statements by others to "prove" mismanagement where there is none.

These are the facts:

The royalty management program has enjoyed tremendous improvement since 1982, when MMS was created to take it over. The program has won praise from the Government Accounting Office, which testified before Congress in April that the Department has made "noteworthy progress" in resolving past problems; and from Senator William Proxmire, who stated recently the Interior Department "deserves a pat on the back for beginning to do a difficult job well."

The $5.8 billion revenue loss, a figure your reporters picked up from a seriously flawed Congressional report, is simply not credible. I personally showed your reporters how the report's analysis was so faulty as to completely discredit the conclusion. They told me at the time they could see that the analysis was grossly in error, but they saw no reason to doubt the $5.8 billion bottom line. Their logic escapes me.

MMS's relationship with companies holding federal and Indian leases might better be described as litigious, rather than, as your paper said, "cozy." Our audits of companies over the past 6 years has resulted in nearly $400 million in additional revenue collections. Currently, we have pending over 540 royalty-related cases brought by companies against MMS; to charge that MMS routinely "sides" with industry doesn't square with the facts.

Such distortions ill-serve your readers and, to those who know the truth, damage the credibility of your newspaper.

Sincerely,

(SGD) WM. D. BETTENBERG

Director

bccs: MMS General File Director's Chron AS/LM (2)
Royalty Management Program (2) Washington & Denver OS/OPA
OMMI File SHall
LMS:OMMI:SHall:lsb:12/09/87:343-3983:Short Letter to AR

United States Department of the Interior
MINERALS MANAGEMENT SERVICE
WASHINGTON, DC 20240

DEC 14 1987

Mr. Alan Moyer
Managing Editor
The Arizona Republic
120 East Van Buren
Phoenix, Arizona 85004

Dear Mr. Moyer:

In early October 1987, your newspaper published a series of articles entitled "Fraud in Indian Country: A Billion-Dollar Betrayal." Several times the series addressed the collection and disbursement of mineral royalties owed to Indians and specifically discussed actions allegedly taken or neglected by the Minerals Management Service (MMS). Prior to publication, MMS provided your reporters many documents and records, and I myself spent hours with them explaining the program. I am disappointed to see that, for the most part, they chose to ignore the facts and instead deliver to your readers a false and misleading story.

In recent years we have seen several other reports in the press about alleged mismanagement of federal and Indian lease revenues, most of them based on the same unsupportable "data" and relying on the same ill-informed sources. We have responsibly refuted these reports and the sources cited by them, the most outstanding examples being an article in the April 1987 issue of Washington Monthly magazine and a seriously flawed Congressional report upon which the article was based. Both of these documents and our detailed responses to each were among the records made available to the Arizona Republic.

The overriding and explicit charge made by the Republic's series against MMS is that the royalty management program is "badly managed" and "poorly run." In fact, the program has been greatly improved since 1982, when MMS was created expressly to take over federal and Indian mineral revenue management. While there have been many studies critical of past mismanagement and MMS's failure to resolve decades of problems overnight, those criticisms simply are no longer valid. The Government Accounting Office (GAO), a close observer and often a severe critic of royalty management, testified before Congress in April 1987 that "in fairness to the Department there has been noteworthy progress made." In the September 29, 1987, Congressional Record, Senator William Proxmire stated about royalty management and its past problems that ". . . the Department is no longer at fault. Instead of a lashing, they deserve a pat on the back for beginning to do a difficult job well." He also said, "Given the complexities of the [the] system, the Department is doing a reasonably good job. A little more time to continue their improvements and they may soon be doing an outstanding one."

RMP-Denver

The Republic's series repeatedly alluded to a $5.8 billion loss of revenues. That figure comes from a 1986 report released by the House Appropriations Subcommittee on Interior and Related Agencies. No similar finding has ever been reported or alleged by GAO, the Department's Office of Inspector General, or any other authority, contrary to what your newspaper stated.

More important is the fact that the $5.8 billion figure is simply not credible, though it has attained near-folklore status among royalty management critics. MMS responded to the subcommittee's report within days of its release and soundly refuted most of the report's conclusions, chief among them an unsupportable 21-percent underpayment "projection," which is the basis of the billion-dollar-a-year loss estimate. As Senator Proxmire said, "The only thing wrong with this number is that it is based on analysis so faulty that a freshman statistics student would receive a big, fat 'F' if he handed it in." Your reporters received a copy of our response, and they were told that no one has challenged a word of our rebuttal -- not in a report, not in a hearing, not in a memo, not in any way. My interview with them, in fact, began and ended on the subject of the $5.8 billion figure. I spent a significant amount of time reviewing with them the flaws in the subcommittee's analysis of underpayments and was stunned to be told at the end of the interview that, while your reporters understood that the analysis was grossly in error, they saw no reason to doubt the conclusion. I am not at all surprised, therefore, that the $5.8 billion myth was resurrected in your newspaper.

Another repeatedly articulated charge in the Republic's series was that MMS sides with industry in matters of royalty management. You state there is concern about our "cozy relationship" with companies MMS is supposed to regulate, and quote Rep. Sidney Yates stating that I have "taken sides with the oil and gas companies," and have said so. The allegation, like so many others in your series, is simply false and the evidence presented is distorted.

The quote attributed to Mr. Yates appears to be an out-of-context remark made in an exchange between Mr. Yates and me at a 1987 appropriations hearing. The subject of our discourse was a particular regulatory proposal made by MMS and, in that particular instance, favored by industry. I stated in response to Mr. Yates that MMS's position and that of industry were essentially the same. I did not mean, and I don't believe that Mr. Yates construed from my remarks, that I or MMS routinely sides with industry. In fact, MMS's position on the regulatory proposal to not use Federal Energy Regulatory Commission ceilings as the minimum for gas valuation purposes has been endorsed by six Western governors and by many in Congress. In November 1987, the U.S. House of Representatives passed legislation supported by Mr. Yates (H.R. 3479) to implement this position. Similar legislation has been approved by the Senate Energy and Natural Resources Committee.

It is surprising that anyone would characterize our relationship with industry as cozy, given that MMS has collected, through its auditing of companies between October 1981 and August 1987, $307 million in additional royalties and late payment charges, and has denied $80 million in refund requests. MMS's demands for payments on 1,900 leases have resulted in administrative appeals and judicial litigation by companies. Currently, royalty-related cases brought by companies against MMS include 350 appeals pending before MMS; 137 appeals pending before the Interior Board of Land Appeals; and 59 cases in court.

I have tried to be selective in the points I would most particularly want to clarify for your readers. Enclosed is a more detailed, point-by-point response to the many errors in your series. You are, of course, welcome to share it with your readers as well, and I encourage you to do so. I hope the information contained here and in the more detailed package will be helpful to you and your staff, should the Republic report further on the MMS royalty management program.

Sincerely,

(SGD) WM. D. BETTENBERG

Director

Enclosure

bcc: MMS General
Dir. Chron
AS/LM (2)
RMP (2) Washington & Denver
OS/OPA
OMMI File
Hall
LMS:OMMI:SHall:lsb:12/07/87/343-3983:Letter to Arizona Republic
Revised 12/08/87 WDB's edits and comments:SHall:vsh
Revised 12/09/87 WDB's edits:SHall:lsb

RESPONSE TO THE ARIZONA REPUBLIC ARTICLES OF OCTOBER 4, 1987

Management of the Oil and Gas Program

Assertions:

"The federal oil and gas program . . . is so badly managed that it has shortchanged many Indians who have leased lands to oil companies . . . "

"Reports document fraud, waste and mismanagement at every stage of the leasing, royalty-collection and disbursing procedure."

"Indian programs run by other federal agencies . . . the Minerals Management Service . . . also are poorly run or in trouble."

Response:

The Department of the Interior (Department) has acknowledged since 1980 that insufficient attention had been paid to the collection of mineral revenues during the 1970's. As world oil prices increased, so did oil, gas, and coal royalty revenues from Federal and Indian leases. By 1981, total royalties exceeded $4 billion, most of which was being remitted through various field offices of the U.S. Geological Survey (USGS) and accounted for in a 20-year-old accounting system. Over the past 6 to 8 years, however, the Department has taken a number of major actions to correct this situation and to improve the "royalty management program."

In 1979, work began to replace the old accounting system. In 1981, Secretary Watt chartered a high-level advisory committee to hear from outside experts what was wrong with the program and how it should be corrected. In 1982, the Department proposed legislation to provide or clarify the authorities needed to enforce royalty provisions, and to improve disbursements and reporting to States and Indians. Congress passed a modified version of that proposal, and the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA) was enacted in January 1983. Also in 1982 and 1983, mineral royalty management functions from USGS and the Bureau of Land Management (BLM) were consolidated in the new Minerals Management Service (MMS). In 1983, a new royalty accounting system became operational. In 1985, Secretary Hodel reviewed the work that had been done and the problems which remained to be solved, and issued a Management Action Plan for Royalty Management which laid out plans and time tables to deal with the further concerns of recipients, external review groups, and others.

Simultaneous with these initiatives, MMS was working diligently in less visible areas to improve royalty management. Accomplishments include implementing a major audit program, including cooperative audits with States and tribes; training payors to report and pay timely and accurately to the new accounting systems; developing better reports for royalty recipients; writing regulations to implement the legislation and improve compliance; and contracting to improve computer support. In addition, several specific actions were taken to improve services to Indians. They include:

- Creation of the MMS Office of External Affairs to provide outreach to Indians.

- Creation of the Office of State and Tribal Program Support within the MMS Royalty Compliance Division to provide guidance and assistance to Indian tribes with cooperative and delegated audit agreements.

- Approval of a Memorandum of Understanding between MMS and the Bureau of Indian Affairs (BIA) to define the responsibilities of each agency and to establish a BIA/MMS Joint Steering Committee which meets quarterly to resolve problems and issues affecting Indian royalty management.

- Development and implementation of an Indian Lease Audit Strategy to expedite audit requests, provide information to Indian allottees on the status of audits, maximize audit resources, and identify future audit targets.

- Design and implementation of the State and Tribal Support System (STATSS) to provide Indian tribes and BIA offices with access to data contained in the MMS Auditing and Financial System (AFS) data bases.

The result of these efforts is that while we have not solved all our problems, the management of royalty revenues is greatly improved. The General Accounting Office (GAO) and the Department's Office of Inspector General (OIG) are both auditing the MMS Royalty Management Program (RMP) on a continual basis, but their reports now concern mostly smaller-focus operational issues, rather than the program-wide failures that were documented in previous years. In fact, during a hearing in April 1987, a GAO Associate Director testified that, "I think in fairness to the Department that there has been noteworthy progress made." In addition, in the September 29, 1987, Congressional Record, Senator Proxmire concluded about royalty management that " . . . the Department was no longer at fault. Instead of a lashing, they deserve a pat on the back for beginning to do a difficult job well." Senator Proxmire also asserted that, "Given the complexities of [the] system, the Department is doing a reasonably good job. A little more time to continue their improvements and they may soon be doing an outstanding one."

MMS Honor System Provides No Accountability

Assertions:

"The program is 'a system that totally relies on the good faith and trust of the (oil) producers' and whose potential for fraud is 'phenomenal,' according to Steven Moore, a Denver-based attorney who works with Indian issues."

"The BIA and the minerals agency have allowed oil companies to pump billions of dollars worth of oil from Indian lands with little of no accountability by letting companies operate on an 'honor system.'"

"'Our concern with the system is that as it is designed, it has no way to ensure the accuracy of payments,' Moore said.
"'It is a system that totally relies on the good faith and trust of the producers.
"'Indians have about run out of belief in this good faith and trust. The potential for fraud in this system is phenomenal.'"

Response:

The MMS RMP is operated similarly to income tax reporting under the Internal Revenue Service. Those who owe royalties are expected to report and pay the correct amount due to the Federal Government. But just as with the Internal Revenue Service, MMS's collection and verification efforts do not stop at that point.

Because we anticipated that there would be discrepancies and delays in payment and reporting, we have implemented several approaches to detecting and verifying that full payment has been accurately identified and made. These approaches include:

- Audits. Payments made to MMS are subject to audit. The MMS royalty audit program is implemented by the Royalty Compliance Division (RCD) and by State and Indian tribal auditors working with MMS under delegated agreements and cooperative agreements. The RCD audit resources are available from 13 resident audit teams and 19 mobile teams. Audit collections and refund denials total more than $387 million from program inception in October 1981 through August 1987.

- AFS Exception Processing. A function of the AFS, MMS's computerized royalty accounting system, is to detect late payments and certain types of underpayment. Exception processing is the identification of conditions that result in billing actions. The AFS generates billable exceptions by comparing what a payor reports and pays to what the system expects the payor to report and pay. Exception processing has been operational since February 1985 and has brought in additional collections of almost $20 million through August 1987.

- PAAS/AFS Comparison. The Production Accounting and Auditing System (PAAS) is an integrated system of manual procedures and automated processes for minerals production reporting, accounting, and auditing. The PAAS is designed as an extension of AFS which collects and accounts for royalties owed and paid for production from Federal and Indian leases. Based on data provided on production reports, PAAS identifies the amount of production that should be reported to AFS as sold. Sales volumes reported to AFS should match those reported to PAAS. The two systems were designed so that data would be compared regularly to identify instances of underreporting, overreporting, and nonreporting. Such comparisons have resulted in the collection of approximately $14.8 million in additional royalties from April 1985 through August 1986.

Presently, PAAS is operational for offshore, solid minerals, and a limited number of onshore Federal and Indian oil and gas leases. On June 18, 1987, the Assistant Secretary - Land and Minerals Management directed that MMS become the agency responsible for the receipt, entry, edit/error correction, and distribution of onshore production data. As a result of this decision, an implementation plan was developed which includes software development, database verification, contractor hiring and training, operator training, and the determination of State and Indian report requirements. Because of the large scale of onshore oil and gas operations, automation of production data will occur in a phased manner with timing dependent on availability of funding and other considerations.

In addition to these efforts, MMS has a comprehensive enforcement and penalty strategy to encourage prompt and accurate royalty reporting and payment. The tools used to carry out this strategy include (1) interest charges, (2) erroneous, late, and nonreporting assessments, and (3) civil penalties.

Royalty Undercollections

Assertions:

"A 1986 congressional study found that the federal government since 1979 has allowed oil companies to pump millions of barrels of oil from federal and Indian lands through an 'honor system' that cost U.S. taxpayers and Indians an estimated $5.8 billion."

"The losses to Indians and American taxpayers are staggering. The windfall to oil companies has been placed at more than $1 billion a year in studies by the Interior Department's inspector general, the General Accounting Office and congressional panels."

"The federal studies and congressional testimony reveal the Minerals Management Service is recovering less than 8 percent of all royalty underpayments for oil and gas on Indian and federal lands.

"The minerals agency, in the past four years, has reported recovering $360 million in underpayments from oil companies. In a recent interview, Bettenberg said this was the only accurate figure regarding the amount lost through underpayments for oil and gas taken from federal and Indian lands.

"But congressional investigators in a 1986 report estimated that federal agencies since 1979 had failed to collect $5.8 billion.

"Numerous federal audits, investigations and congressional hearings have established that the two agencies are allowing oil producers to literally steal hundreds of millions or even billions of dollars of oil and gas from federal and Indian lands."

"The BIA and other Interior Department agencies have shirked their mandate by failing to protect Indian interests in oil and gas production.

"An estimated $5.8 billion has not been collected since 1979 from companies that pumped oil and gas from Indian and federal lands, thus robbing the Indians and the government of possible billions in potential royalties."

Response:

These assertions refer to a statement contained in a report released in **September 1986** by the House Appropriations Subcommittee on Interior and **Related Agencies.** No similar statement has ever been made by the OIG, the GAO, or any other authoritative group.

The Subcommittee's report projects (but does not "claim" or "find") aggregate undercollections of 21 percent based upon audit findings which yielded additional billings totaling 21 percent. The MMS warned both the authors and readers of the Subcommittee's report that these audit statistics could not be projected to the universe of leases and payments for the following reasons:

- The MMS audit sample was limited to leases on which there were underpayments. Leases on which royalties were properly paid or overpaid were not included.
- The MMS auditors concentrate on leases, time periods, and circumstances where underpayments are most likely to occur. Results from those audits cannot be extrapolated to the universe of leases and payments.
- Many of the audit findings were based on MMS interpretations of complex issues, which the payor is appealing or litigating, and which may ultimately be decided in favor of the payor.
- Perhaps of greatest importance, the audits covered periods back as far as 1978, well before the improvements in royalty collection and compliance of the past few years.

For similar reasons, Senator Proxmire has stated in the Congressional Record that, "The only thing wrong with this number is that it is based on analysis so faulty that a freshman statistics student would receive a big, fat 'F' if he handed it in."

It may help to explain that there is a difference between:

underpayments - the difference between the amount initially paid and the amount owed, and

undercollections - the difference between the amount finally collected after MMS audits and the amount owed.

As thus defined, undercollections are a true loss of income; but underpayments may only reflect a delay in income--for which we are compensated by interest assessments.

We have never denied that initial underpayments exist. Just as with the Internal Revenue Service, it is not possible to collect all revenues "up front" when initial payments are based on voluntary compliance. Although we expect lessees to comply in good faith with applicable laws, regulations, and lease terms, we have differences of opinion as to what compliance requires.

These differences will not all be resolved until administrative and legal appeal are exhausted--a process that will take years. However, many will be resolved more directly in our proposed product value regulations and in litigation that may ensue on those regulations.

We believe the safeguards are in place to ensure that ultimate undercollections are minimized. That is why we have created a 200-person audit staff over the last 5 years to regularly audit payors and why we routinely check to see that payments are made on time and for all producing leases.

Royalty Undercollections - Comment by Congressman Yates

Assertions:

". . . Rep. Sidney Yates . . . sticks by his staff's 1986 study saying the losses since 1979 are in the billions. That report, he said, is based on staff research and General Accounting Office findings."

"Yates said in a recent interview that neither Bettenberg nor other government officials have provided evidence refuting those figures."

Response:

We are surprised at such a statement. On October 1, 1986, Secretary Hodel signed a letter to Congressman Yates forwarding the Department's detailed response to the staff report. Attachments to that letter pointed out that the estimate of underpayments was "unsupportable" and "grossly inflated." The warnings about using Federal audit data to make statements about the lease universe were repeated. It was also pointed out that three of the four States whose data had been used in the staff report had been contacted and that all three "claimed no ownership of the information used in the report." Other reviewers have agreed with MMS personnel that the staff report's estimate was unsupportable. To the best of our knowledge, not a single sentence of our 80-page response has been refuted by anyone in the past year. We stand by our response.

From time to time MMS has been asked to estimate the percent of initial underpayments. The MMS has not made such an estimate because it would require audits of a very broad-based sample of leases, including those overpaid or properly paid. The MMS believes its available audit time is better spent on areas likely to reveal undercollections. We understand that both the OIG and GAO have provided similar advice to Congressman Yates. In fact, in a hearing before the House Subcommittee on Mining and Natural Resources, the GAO witness stated, "We have talked to everybody that we can think of - industry, states, the Indian organizations, the Federal side - in terms of how does one get at what the potential underpayment is out there, what is the order of magnitude. Quite frankly, we have not been able to identify a viable way to do this."

"The firms are allowed to estimate the amounts they owe the government for the oil and gas because federal agencies cannot accurately monitor oil production from Indian and federal lands. The oil companies are supposed to be audited every six years under this arrangement."

Response:

The statement by The Arizona Republic that "This estimate is necessary because the BIA and the minerals agency have no accurate way of measuring oil and gas production" is inaccurate. The reporting of estimated sales and the monitoring of production are not related.

The purpose of estimates is to allow royalty payors an additional month to report actual royalties. Royalties are based on sales of the mineral products, not on production. In accordance with lease terms and FOGRMA, royalties and their accompanying reports are due by the end of the month following the month of sales. However, industry practices usually preclude this prompt reporting and paying of actual royalties because the information needed is not available to the royalty payor within that timeframe. The FOGRMA regulations recognize this problem and allow for an estimated payment the month that royalties are due. The following month, the payor must report the actual royalty amount. If the actual royalties reported are greater than the estimate paid, the royalty payor is charged interest for late payment on the amount that the actual royalties exceeded the estimated payment.

Production is monitored through the MMS PAAS (most onshore oil and gas production is reported to BLM rather than MMS, but a reporter shift to MMS is planned). The PAAS is designed as an extension of the AFS, which collects and accounts for royalties paid on Federal and Indian leases. Based on data provided on production reports, PAAS identifies the amount of production that should be reported to AFS as sold. The two systems were designed so that data would be compared regularly to identify instances of underreporting, overreporting, and nonreporting. This comparison has been operational for Federal offshore leases, all solid mineral leases, and as a pilot for Federal onshore and Indian leases for over two years.

It should be noted that the Royalty Management Advisory Committee, comprised of members of the oil industry, states, and Indian tribes, voted 19-1 to retain the estimated payments process.

Product Value Regulations - Comment by MMS Director Bettenberg

Assertions:

"Last year, during congressional hearings, Bettenberg, the Minerals Management Service director, acknowledged, 'There's a certain amount of chaos out there.'"

Royalty Undercollections - Comment by MMS Director Bettenberg

Assertions:

"At a recent budget hearing, Interior Department officials bristled at congressional allegations that companies may be illegally taking $1 billion worth of oil from federal and Indians lands each year.

"The figure, according to William C. [sic] Bettenberg, director of the Minerals Management Service, was only in the hundreds of millions.

". . . industry experts place underpayments at about 3 percent of the total royalties due to Indians.

"That still would put the losses in the tens of millions each year."

Response:

This is apparently a reference to an exchange between Mr. Bettenberg and Congressman Yates during a September 1986 hearing on royalty management issues.

"Mr. Yates. So you know that there is a big amount that is uncollected, a huge amount that is uncollected. In the hundreds of millions.

"Mr. Bettenberg. Some place, certainly, in the hundreds of millions since we have collected $320 million. . . ."

That is, to go back to our earlier response, our audit results verify that "initial underpayments" have amounted to "hundreds of millions," primarily because of differences in positions regarding product valuation. (We hope to narrow these differences in positions through the publication of improved product value regulations.) However, this is not to imply that we believe that hundreds of millions of current royalties due will ultimately go uncollected.

Estimated Payments

Assertions:

"That admittedly flawed honor system allows oil firms to pay the government based on estimated production, because federal agencies have no way to accurately monitor the oil production."

"The royalty payments, based on "estimated production," are made to the minerals service . . . "

"The agency quickly found it could not comply with the 1981 Federal Oil and Gas Royalty Management Act. Instead of requiring companies to pay as they produced, the minerals service instructed them to "estimate" payments for oil and gas production on federal and Indian lands.

"This estimate is necessary because the BIA and the minerals agency have no accurate way of measuring oil and gas production."

Response:

This statement was taken out of context from an exchange between Mr. Bettenberg and Congressman Yates at the April 15, 1986, hearing of the House Appropriations Subcommittee on Interior and Related Agencies. The topic of the discussion was product value regulations, and the comments made by Mr. Bettenberg were intended to refer to that topic and not to the Royalty Management Program as a whole. The record reads as follows:

"Mr. Yates. How in the world can a company presently know whether it is complying with what you expect them to do? If they have no guidelines, how can your auditors know whether the company is complying? Isn't it total chaos?

"Mr. Bettenberg. It is not total chaos.

"Mr. Yates. It is just chaos.

"Mr. Bettenberg. There is a certain amount of chaos out there. There are two problems. The first is, basically our guidance at this point isn't as clear as it needs to be."

Clarification of product value guidance began in 1982. Draft proposed rules were published in early 1986 in the Federal Register (with an accompanying press release and briefings of the press and congressional staff) and reviewed during that year by the Royalty Management Advisory Committee. Since the above quoted comments, MMS published proposed rules in early 1987 and provided a 90-day comment period. Comments were received by over 100 submitters representing industry, States, Indians, and other Federal agencies.

These regulations tend to be controversial at least in part because any increases in royalty revenues would come from industry accounts and any decreases would be borne at least in part by the States and Indian lessors. Some representatives of States, Indians, and industry chose to take their concerns about the regulations to the Congress. The FY 1987 Supplemental Appropriation contained a provision prohibiting the implementation of final regulations prior to November 1, 1987. The Department reached an understanding with the congressional staffs involved that, in the meantime, MMS would publish a draft of its final rules for an abbreviated period of public comment before proceeding to finalize the rulemaking by September 30, 1987.

After the draft final oil and gas valuation rules were published on August 17, 1987, the House Interior Committee requested another chance to resolve the remaining differences on essential provisions of the regulations. This led to a series of meetings with representatives of Indians, States, and industry and with interested congressional staff. It also resulted in the second draft of the final rules that was published on October 23, 1987, for public comment.

Contrary to the comments of some observers, the minerals accounting function can hardly be characterized as a simple process. The systems RMP designed and installed closely parallel those currently being used in industry and in some of the more sophisticated State royalty accounting systems, thereby facilitating data and information exchange. The systems and procedures RMP operates were designed and are constantly being modified to respond to the increasing information requests from RMP's clientele, the States, Indians, and industry. For example, the State and Tribal Support System (STATSS) has been designed and implemented to provide computer terminal access and data manipulation capability to the States, tribes, and BIA.

In 1985, the Department awarded a contract to Martin Marietta Data Systems (MMDS) to install an IBM mainframe computer and convert the AFS from the VAX minicomputer configuration. The major benefits of operating the AFS on the mainframe include increased capacity and speed, on-line terminal access to make data corrections, the ease with which enhancements can be programmed, and the ease with which data can be retrieved and special reports prepared.

Recently, RMP completed a study to identify improvements to RMP's automated systems as well as the program overall. The RMP study identified 49 proposed improvements which will allow RMP to simplify reporting and payment requirements, improve accounting and cash management practices, improve enforcement and compliance procedures, accelerate payments to recipients, and streamline audits.

The RMAC reviewed the recommendations, modified several and added one recommendation, endorsing them to the Secretary in October 1987. Department approval and initiation of work on improvements is expected in late 1987.

Department Siding With Oil Companies

Assertions:

"Members of Congress and their staff members interviewed by The Republic expressed deepening concern over the growing cozy relationship between the Interior Department, the minerals service and the BIA and the oil and gas companies they are supposed to regulate.

"For example, interior officials in 1986 decided to let Conoco, a major oil company, write valuation guidelines for oil and gas production.

"Minerals Management Service officials acknowledged that the Conoco proposals would have given oil companies a $600 million windfall at the expense of Indian landowners and taxpayers. The minerals agency's royalty-advisory committee rejected the Conoco plan, but a new plan being drafted by the agency will have about the same effect, critics allege."

Response:

It appears that The Arizona Republic has borrowed from an article in the April 1987 issue of the Washington Monthly. The fact is that the Department has been developing revised product value regulations since 1982. In early 1986, as a step in this process, the Royalty Management Advisory Committee

System Problems

Assertions:

". . . the government's system of collecting royalties and getting that money to Indians or the U.S. Treasury is inept at best."

"The collection and disbursement of oil and gas royalties is unnecessarily complicated, critics charge."

"Bettenberg concedes the oil and gas royalty program does not merit confidence today. But he predicts that 'substantial compliance,' is 'about two years away.'"

"But even the most optimistic say the agencies' ability to expedite payment is poor, primarily because of an archaic accounting system that, according to a recent congressional report, makes everything 'unnecessarily complex.'"

"Albuquerque attorney Al Taradash, who represents the Indians, said that a judge recently ordered the BIA and the minerals service to make timely royalty paymed the BIA and the minerals service to make timely royalty payments. But the system is so bad there are serious questions as to whether the agencies can comply, he said."

Response:

The Department's initial efforts to design and develop an improved royalty system began in 1979, following years of criticism focusing on the inadequacies of the USGS's Royalty Accounting System (RAS). A Task Force report and subsequent policy paper formed the basis for design and development of the replacement systems used by RMP today. These systems are the AFS and PAAS. Five years of implementation experience has identified the following significant improvements over RAS:

- Centralization of policy formulation and accounting functions.
- Provision for the first time of detailed royalty-related information to States, Indian tribes, and industry.
- Automated processing of financial and production accounting data by a modern computerized system.
- More efficient and timely disbursement of monies to recipients.

The FOGRMA imposed greater information gathering and sharing requirements on the systems RMP was developing. In reponse to State and Indian desires for a fuller partnership in the Royalty Management process, the Congress mandated that RMP deliver explanation of payment information regarding the nature and source of payments to royalty recipients. Further, the delegated and cooperative audit program provided for States and Tribes in FOGRMA dictated additional information gathering and sharing.

established three work panels to review and comment on drafts of MMS's proposed rules for oil, gas, and coal valuation. Each of the work panels was comprised of State, industry, and Indian representatives selected for their knowledge of and interest in a specific commodity. The 32 members of these panels devoted a tremendous amount of time to this effort, including holding 29 days of formal sessions which were open to the public. The MMS paid the costs incurred by panel members in attending formal sessions, while their salaries were paid by their employers. Each panel made its own arrangements for having its work products recorded and reproduced.

We believe this allegation refers to the fact that a Conoco employee who was a member of the oil panel offered to provide these clerical services for the oil panel. As a result, Conoco had each session's products typed and distributed to each panel member prior to or at the next session. These products were then available for review, discussion, and, if necessary, correction by each member of the work panel during public sessions.

In summary, The Arizona Republic article grossly misstates the facts.

The $600 million amount is apparently a reference to an initial MMS estimate of the impact of the proposals of the oil and gas work panels on potential royalty revenues. These estimates were discussed during the October 1986 meeting of the Advisory Committee. During that public discussion, it became apparent that MMS analysts had misunderstood the intent of one specific proposal by the Gas Work Panel and that they had erroneously assigned to it an $311 million price tag. Questions were raised also about other aspects of the MMS estimates.

Nevertheless, MMS believed then and now that the oil and gas work panel proposals would have resulted in reduced royalties. That is one of the reasons the full Advisory Committee was unable to muster the two-thirds majority to forward recommendations regarding the oil and gas regulations to the Secretary.

Since October 1986, MMS has published proposed regulations for oil and gas product valuation and, now, two sets of draft final rules for public comment. Throughout this process, MMS adopted those comments that it felt improved the proposed regulations and rejected others, including a number of recommendations from the oil and gas panels.

Department Siding with Oil Companies - Comment by Congressman Yates

Assertions:

"Rep. Yates echoed Synar's allegations that department officials are siding with oil companies.

"He said that Bettenberg has 'taken sides with the oil and gas companies, and he said so.'"

Response:

This is apparently a reference to an exchange between Congressman Yates and Mr. Bettenberg at an April 1987 appropriations hearing. The topic was a January 1986 proposal to modify the provisions of Notice to Lessees and Operators No. 5 (NTL-5):

"Mr. Yates. What comments did you receive as a result of the publication?

"Mr. Bettenberg. Let's see. In general, the states have taken the position that it shouldn't be made retroactive and industry has taken the position it should be made retroactive.

"Mr. Yates. In other words, you side with industry on this one?

"Mr. Bettenberg. I think that our position on that is essentially the same as theirs, yes."

In summary, Mr. Yates did not state at the hearing that MMS is routinely "taking sides with the oil and gas companies." His comment and Mr. Bettenberg's reply were related solely to positions taken on the specific questions of whether certain changes to NTL-5 should be made retroactive. We note that in July 1987 the Governors of six Western States adopted a position supporting the retroactive modification of NTL-5, subject to certain safeguards with which MMS and the Department agree. Further, in November 1987, the House of Representatives passed legislation (H.R. 3479) supported by Mr. Yates to implement this position. Similar legislation (S. 1814) was voted out of Committee in the Senate in December 1987.

It is hard to maintain that anyone in the MMS is routinely "siding with the oil companies," in the face of the following statistics:

- From October 1981 to August 1987, the MMS collected $307 million in additional royalties and late payment charges, and denied $80 million in refund requests, through its audit program.
- Demands for payment on 1,900 leases have resulted in appeals and litigation.
- Currently, companies have, on royalty-related issues:
  - -- 350 appeals pending before the MMS Director (reflecting actions taken by Royalty Management personnel which are contested by companies),
  - -- 137 appeals pending before the Interior Board of Land Appeals (reflecting decisions or actions of MMS contested by payors),
  - -- 59 cases in court (reflecting decisions or actions of MMS contested by payors).

Causes of Underpayments

Assertions:

"Most of the losses are through underpayments from oil companies that either lie about the amount of oil they take or about its value."

Response:

While it is true that the MMS collects substantial additional royalty payments over those initially reported by oil companies, we do not believe these collections typically result from lies by oil companies. The majority of audit collections are due to differences in interpretation of complex product valuation regulations.

Washington Monthly Article

Assertions:

"A recent issue of Washington Monthly singled out the oil and gas management as Washington's worst-run program."

Response:

The Washington Monthly article made numerous inaccurate statements and mischaracterizations regarding the MMS Royalty Management Program, including the allegation that it is "Washington's worst-run program." The MMS sent a detailed response to the magazine refuting the major allegations contained in the article. However, the Washington Monthly has not recognized or responded to this response.

Past Study/Audit Recommendations

Assertions:

"Since 1955, three task forces, a blue-ribbon panel, numerous consultants and repeated audits by the GAO have warned that the multibillion-dollar oil and gas program was headed for severe problems. Yet Interior Department and BIA officials have ignored the warnings and advice."

Response:

The Department does not ignore the recommendations of outside audit groups, of the Department's OIG, or of other persons or groups which conduct responsible studies of its operations. Recommendations are carefully evaluated, and a response is provided to the sponsoring organization. Since 1980, most of the recommendations received have been implemented or are in process. Others have been deemed to be impractical or inappropriate, and in those cases, a written response has been provided to the sponsoring organization.

While it is true that past GAO reports indicated severe problems in the oil and gas program, recent reports regarding the MMS have concerned mostly smaller-focus operational issues. In fact, during a hearing before the House Committee on Interior and Insular Affairs, Subcommittee on Mining and Natural Resources in April 1987, a GAO Associate Director highlighted the program gains since 1979 and testified that, "I think in fairness to the Department that there has been noteworthy progress made."

Additional Auditors

Assertions:

"Despite this low collection rate, Bettenberg, in 1986 testified before Congress that his agency needed no more auditors to manage the oil and gas accounts.

"But Congress, in an unusual move, insisted the agency hire 50 more auditors, based on the promise that their work could bring in at least $20 million in recovered underpayments.

"In a recent interview with The Republic, Bettenberg cited the hiring of those 50 auditors as one of the recent achievements of his agency. He did not say Yates' panel forced his agency to hire them."

Response:

Funding for the 50 additional auditors was based on an MMS analysis completed after the April 1986 hearing and furnished to the House Appropriations Committee. The additional auditors hired in Fiscal Year (FY) 1987 will significantly contribute to audits that determine the accuracy of royalty payments on Federal and Indian mineral leases. Overall the audits are cost-effective because additional royalty revenue is collected for the Federal Treasury, State governments, Indian tribes, and Indian allottees. However, it is difficult to determine the benefits of the additional 50 auditors in recovered royalty underpayments because of the following factors:

- With the market value of oil and gas declining in past years the dollar value of royalty underpayments may decrease as audits occur for more current periods.

- The new auditors need training and experience in royalty compliance activities to achieve their full level of effectiveness. As their knowledge and experience increase so will their ability to generate additional royalty collections.

- The downturn in the oil and gas industry has had a greater impact on small and intermediate companies and resulted in numerous mergers and acquisitions. Past levels of payor compliance will be affected by these economic impacts.

- The MMS royalty audits are conducted on an audit team basis. Statistics are not maintained on an individual auditor basis.

Indian Advocacy System

Assertions:

"Although federal officials in the past three years have developed an advocacy system for Indian landowners, it, for the most part, has failed to improve the system."

Response:

The MMS has undertaken a number of actions over the past several years which relate to Indians and which we feel have greatly improved the program. The following actions are not all inclusive but represent some of the major initiatives.

Royalty Management Advisory Committee. The Royalty Management Advisory Committee was formed in late 1985 to review royalty issues identified by the Secretary of the Interior and provide him with recommendations for resolving the issues. The Committee is comprised of members representing several Indian tribes and an allottee organization, State governments, industry, and the general public. The Committee had a total of five committee meetings in 1986 and 1987. To assist it in reviewing issues the Committee appointed several working panels comprised of members from the same or similar organizations to those of which the Committee members represent. The Committee and its working panels have reviewed the following issues to date:

- Federal funding guidelines for implementation of FOGRMA Sections 202 and 205.
- Efforts by MMS to validate the AFS data bases.
- Draft oil, gas, and coal valuation regulations.
- The application of the PAAS to onshore Federal and Indian leases.
- System improvement efforts.

The Indian participation on the Committee and working panels is summarized as follows:

	Royalty Management Advisory Committee Members		Working Panel Members	
	Number	Percent	Number	Percent
Indian Members	7	23	19	26
Non-Indian Members	23	77	53	74
Total Members	30	100	72	100

Indian Lease Audit Strategy. In January 1986, BIA and MMS implemented the BIA/MMS Indian Lease Audit Strategy. The strategy was approved by the BIA/MMS Joint Steering Committee and establishes procedures for the bureaus to receive and respond to Indian tribal and allottee lease inquiries. Numerous audits and accounting reviews have been accomplished or are in process to respond to such inquiries.

In FY 1986 and 1987, the MMS Royalty Compliance Division conducted audits of 40 Indian leases and 114 Indian leases, respectively, as a result of such referrals. In addition, in FY 1986 the MMS Office of External Affairs (OEA) conducted accounting reviews based on 16 allottee requests and in FY 1987 conducted accounting reviews based on 32 such requests.

Indian Audit Activities. The MMS audit strategy is being revised to provide improved audit coverage of Federal and Indian leases. The MMS plans to direct the vast majority of its audit resources toward major payor company audits. The MMS is developing a comprehensive plan to audit on a 6-year cycle the largest payors who submit over 90 percent of total mineral revenues. Payors on other leases will be reviewed for audit pursuant to special audit techniques. Also, the MMS will assure audit coverage of the balance of Indian leases through major company audits, payor audits and specific audit requests through the BIA/MMS Indian Lease Audit Strategy. Since program inception in October 1981 through August 1987, MMS has collected $15 million in additional royalties and late payment charges as a result of the collective lease coverage efforts on Indian leases. During FY 1987, MMS audited 162 tribal and 323 allotted leases. Since 1982, 1,768 of the 4,700 producing leases have been audited.

Special emphasis has been placed on audits of nonstandard Indian lease agreements issued under the Indian Mineral Development Act of 1982. A total of 47 such agreements have been identified, and audits have been initiated by MMS on 5 agreements, representing 14 leases. An additional $444,000 in revenues has been collected as a result of these audits.

In addition to audit activities by the Royalty Compliance Division, Section 202 of FOGRMA authorizes cooperative audit activities with tribes. One tribe has an agreement with MMS to perform audits. In addition, two tribes have informal cooperative agreements whereby MMS auditors and tribal auditors work together on an audit. Several other tribes are considering entering into such agreements with MMS.

Establishment of OEA and Outreach Visits. The OEA was established in August 1985 to promote communication and understanding between royalty recipients and MMS. It is an ombudsman to Indian allottees and tribes with the goal of promoting greater understanding and assistance. It is the primary conduit in MMS for royalty recipients to seek problem resolution. It conducts an outreach program insuring RMP coordination and continuing communication with the Indian community.

Since mid-1986, OEA has held 15 meetings with allottee groups in Oklahoma, New Mexico, Wyoming, and Colorado. During this same period OEA has held 12 meetings with tribal organizations in Arizona, Wyoming, Montana, and Colorado. The purpose of these meetings is to share information concerning the RMP, review the accounting and auditing functions that are the responsibility of MMS, and respond to inquiries concerning individual lease problems. Representatives from the BIA accompany OEA personnel on field visits.

Another major outreach initiative started in August 1987 is visits with tribes and allottee groups concerning MMS efforts to improve its accounting systems. Nine meetings with Indian organizations have been held between August and October 1987.

State and Tribal Support System. On April 30, 1986, STATSS was implemented. This system provides access to AFS data via terminals and remote personal computers through a series of online computer screens and financial reports. Nine States, nine tribes, and fourteen BIA offices use STATSS. Data access is protected so that a user can only see data for leases pertaining to that user. Each BIA office with STATSS capability has access to data for allotted leases that are under its jurisdiction. In addition, MMS purchased microcomputers and gave them to the tribes to encourage use of STATSS.

A permanent STATSS section within the RMP provides user assistance to States, tribes, and BIA and RMP personnel. Through FY 87, this section has trained over 150 users, handled several hundred phone calls, and distributed over 5000 separate STATSS financial reports in response to user requests.

VAX Computer System

Assertions:

"The minerals agency struggled with an $82 million VAX computer system that could not handle data properly or produce timely accounting for oil and gas transactions. The VAX problems set the entire minerals-management program back at least two years, officials agree."

Response:

The MMS has not spent $82 million on the VAX computer system. Since inception of the RMP in late 1981, approximately $50 million has been incurred to purchase VAX minicomputers, develop new financial and production systems, and operate and maintain all systems. The MMS has recently completed acquisition of a new mainframe computer and has converted the AFS. While costs associated with the new computer were originally estimated at $32 million, actual costs are about $23.6 million, including operations and maintanence. Had the RMP systems originally been implemented on a mainframe computer instead of VAX minicomputers, the primary cost savings to the government would have been $4.3 million for VAX hardware and $4.2 million for conversion, a total of $8.5 million. Most of the other costs would have been incurred in either case.

BIA/MMS Communication

Assertions:

"BIA and minerals-service officials argued and fought over the resource-management problems. The feud deteriorated to the point where officials of the two agencies were barely speaking to each other.

"While officials of the agencies bickered, Indians who owned mineral rights were starving and losing their homes and cars because they could not get their money."

"The problems also are compounded by a computer system that has failed miserably and a paralyzing lack of communication between the minerals agency and the BIA."

Response:

We are surprised at the statements about lack of communication between BIA and MMS. To our knowledge, nothing like a "feud" ever existed between the two agencies, and coordination meetings were always held. However, MMS and BIA do acknowledge that a more effective mechanism for coordination and communication was needed. Therefore, over the past several years, the two agencies have instituted many activities and mechanisms for coordination. Among actions taken are the following:

- The MMS and BIA signed a Memorandum of Understanding (MOU) in August 1985 to delineate responsibilities related to lease revenue management and lease administration. The MOU is administered by a Joint Steering Committee which meets quarterly to discuss problems and issues affecting Indian royalty management.

- The MMS and BIA issued the Indian Lease Audit Strategy effective January 1986. This audit strategy is designed to (1) enable MMS/BIA to respond to inquiries more rapidly, (2) keep tribes and allottees informed as to the status of their audit requests, (3) maximize use of professional audit resources, and (4) identify future audit targets.

- The MMS and BIA held training sessions for employees with Indian lease responsibilities to make them aware of the Department's trust responsibilities and the roles of each of the Bureaus involved in royalty management.
- The MMS and BIA identified the need for system enhancements to improve the quality of information of the explanation of payments reports sent to tribes and allottees. These enhancements include changes in the calculation of royalty rate and unit price and accounting for negative royalty values.
- The MMS developed and implemented STATSS in April 1986 to provide access to detailed AFS data and a tracking system for Indian lease audits.
- The MMS OEA is involved in outreach to BIA. The OEA has conducted numerous meeting and visits to BIA facilities to discuss mutual projects and problems and to train agency personnel on MMS functions.

IBM Computer/Conversion

Assertions:

"The minerals service and the BIA are pinning their hopes of resolving the multibillion-dollar oil and gas crisis on a new $32 million computer system that originally was scheduled to go on line last year but was rescheduled to begin operation in August.

Response:

The new system, which became operational in September 1987, greatly increases MMS's flexibility and capability to improve its service to the Indians in the future. It has not, however, been billed as a panacea.

Work has already begun to fully utilize the capabilities of the new system. Foremost among these is to implement PAAS for onshore Federal and Indian leases. Onshore PAAS had to await the new system because of the number of leases and transaction volumes involved. Onshore PAAS will allow MMS to compare production reports from leases to the royalties paid by the oil companies. The new system will also allow MMS the flexibility to improve the explanation of payment reports to both the States and Indians by allowing additional explanatory information to be stored and reported.

As stated earlier, the $32 million cost for the new computer cited in The Arizona Republic is incorrect. Cost of the new system through FY 1987 totaled $23.6 million for computer hardware, conversion of the AFS from the VAX configuation to the IBM, and operations and maintenance. The $32 million was an estimate which included additional options MMS chose not to exercise.

Failure to Crack Down on Industry Violators

Assertions:

"When serious violations are brought to their attention, Interior Department officials have failed to crack down on oil companies that apparently violate federal laws, federal studies show.

"In other cases, they have not pursued legal action when oil producers refused them access to oil and gas records as required by law.

"Documents show that oil firms repeatedly have refused to comply with that access-to-records law, seriously hampering the Indians' efforts to get an accurate accounting of the money owed them.

"For example, when major producers Arco and Chevron refused to let Interior Department officials review their records of production from federal and Indian lands, government officials took no action other than to report they were studying 'appropriate strategy' to deal with the apparent violation."

Response:

We assume the cases in question relate to OIG "lookback" audits initiated in the 1982-1984 timeframe. It is true that several companies, including ARCO and Chevron, initially resisted OIG attempts to obtain information on oil and gas production. However, it must be pointed out that:

1) OIG lookback audits were conducted by private accounting/auditing firms, and reasonable questions were raised about their authority to obtain proprietary information.

2) Many issues being audited (such as take-or-pay provisions) were being litigated, and companies questioned that they needed to provide information when they believed no royalties were due.

Subsequently, all such cases have been referred by the OIG to MMS for resolution and all necessary documentation has been or is being provided.

The bottom line is that we are not aware of any instances where oil and gas companies are today refusing to furnish records necessary to audit their compliance with Federal statutes except for a few cases where that authority on specific types of payments is in litigation.

Lack of Commitment

Assertions:

". . . no one in the Department of Interior really wants a workable system.

"Synar feels the problems result from a lack of commitment on the part of the BIA and the Minerals Management Service. The Oklahoma congressman said officials and employees of the agencies are more intent on protecting their jobs than on helping Indians."

Response:

We strongly disagree with The Arizona Republic and its report of Congressman Synar's statements that the MMS lacks commitment. In a number of audits and studies conducted by outside organizations the reviewers have commented on the high level of commitment from MMS employees. For example, a December 1984 report by the House Committee on Interior and Insular Affairs stated, "Employees of the MMS have shown a high sense of dedication to getting the job done, and have been led by management personnel who have been equally hard working for the most part." In fact, a July 1985 report from the House Committee on Government Operations, Environment, Energy, and Natural Resources Subcommittee chaired by Congressman Synar states, "During the course of the Subcommittee's investigation, it was evident that many Departmental employees are working diligently to carry out their duties and to correct problems in the program."

Statements by Beatrice Saupitty

Assertions:

"Beatrice Saupitty . . . is a prime example of the problem.

". . . recently, the BIA stopped the royalty payments that were her primary source of income.

". . . agency officials in Anadarko told her that an oil company claimed $80,000 in overcharges against her account.

"Although the BIA neither attempted to verify that charge nor asked the Minerals Management Service to audit the account, agency officials depended on the honor system and without question charged Saupitty's account.

"Saupitty . . . was upset that BIA officials sided with the oil company and told her she must prove that the company's overcharge was wrong before she could get any money.

". . . Saupitty hire[d] an attorney. That attorney hired an oil and gas auditor, who found that the oil company and the BIA were not due the $80,000. Instead, they had failed to pay Saupitty for an estimated $64,000 in oil and gas taken from her land.

". . . BIA rejects her documented claim and accepts the word of the oil company, which based its overpayment charges on "estimated" production from her land."

"In Oklahoma, the BIA and the minerals service were trying to collect $80,000 for an oil company from a 68-year-old Indian woman. An independent audit revealed the firm actually owed her $64,000.

Response:

At a 1986 MMS/BIA outreach meeting with Indian allottees in the Anadarko Area, Ms. Saupitty (Kopaddy) requested a review of her lease for timeliness of payments. The BIA asked MMS to proceed with the review. The results of MMS's review were presented in a December 12, 1986, memorandum to the Anadarko Agency Superintendent and to affected allottees. The review revealed that Ms. Saupitty's royalty payments were timely and had been paid for the lease.

The $80,000 and $64,000 amounts stated in the news article represent estimated payment balances for different months; i.e., advance royalty payments which were distributed to BIA for disbursement to Ms. Saupitty and other royalty interest holders. Ms. Saupitty is not owed $64,000 as the article claims, nor are BIA and MMS trying to collect $80,000 from her.

On December 17, 1986, members of MMS's Office of External Affairs met with Ms. Saupitty and explained the circumstances concerning her lease. The MMS also met with other allottees with an interest in the lease and explained the situation.

Statements by Berdena Holder

Assertions:

"'They're ripping us off. When I say they, I don't know for sure if it is the oil companies, the BIA, MMS (Minerals Management Service), Treasury or who.'" [Berdena Holder]

"Holder challenges the BIA and the minerals agency almost daily, and in more cases than not, she wins."

Response:

Ms. Holder owns a royalty interest in three leases. The MMS has performed audits and desk reviews responding to Ms. Holder's questions relative to each of her leases. An audit initiated on one of Ms. Holder's leases covering the period of May 1982 through February 1984 found that additional royalties were due. Those royalties were collected and paid to her. Since this audit, numerous desk reviews conducted on this lease have identified the need for further audit coverage. That work is nearing completion. The MMS has also conducted desk reviews on two additional leases for which Ms. Holder has a royalty interest. One of these leases is currently under audit.

During a July 1986 meeting of the Royalty Management Advisory Committee, Ms. Holder publicly claimed that her royalty payments were not timely and asked questions about her payments. Review of this matter by MMS disclosed that the royalty payments in question were paid timely. These findings were discussed with Ms. Holder by MMS representatives and were formalized in a written response to her from the Director, MMS, dated September 9, 1986.

Statements by Roger Bosin

Assertions:

"'I'm trying to find out what happened to my money, and the BIA won't tell me anything,' Bosin said.

"'But the BIA has always taken the side of the oil companies and said, "To hell with Indians."'"

Response:

The MMS audited Mr. Bosin's royalty interest during 1986 for the audit period of January 1980 through December 1985. Audit results were transmitted to the BIA on December 3, 1986. The audit identified $1,866.97 in underpaid royalties. That amount was distributed to BIA on July 15, 1987, and was subsequently disbursed to the royalty owners, including Mr. Bosin, by BIA.

The MMS personnel have received a number of verbal inquiries from Mr. Bosin concerning his lease account and the lease account of his wife. The MMS has been responsive to all of Mr. Bosin's inquiries.

Statements by Frances Begay

Assertions:

"In Arizona, the response Begay got from BIA officials was similar.

"When she approached them in Window Rock to find out why she and other members of her family were not getting paid, BIA officials refused to help and told her, 'You should have saved your money.'"

Response:

In response to a request from the BIA Navajo Area Office, MMS is now auditing Ms. Begay's lease. We estimate that the audit will be completed by January 1988.

POINT PAPER

SUBJECT: "You Think the NSC is Screwed Up? Take a Look at Washington's Worst Run Program"--Article Appearing in The Washington Monthly, April 1987.

The article appeared under the byline of John Eisendrath, Editor, and presented a decidedly unfavorable account of the Royalty Management Program. The article also provided the basis for comments by Representative Miller, which were entered into the Congressional Record for March 31, 1987. General responses have been transmitted by the Director, MMS to the General Editor of The Washington Monthly and Congressman Miller.

In general, the reporter did a fair amount of homework on the history of the Royalty Management Program. He wrote at length of the program's troubled past but, however, totally failed to acknowledge the progress made (Refer to Briefing Paper on RMP Accomplishments).

Below are extracts of the article, organized by subject area, followed by a proposed response.

ASSERTION -- UNDERPAYMENTS:

> According to a report issued last September by the House Appropriations Subcommittee on the Interior, the government may be failing to collect as much as $1 billion a year in royalties. The government, of course, disputes the exact amount, but admits that hundreds of millions of dollars did go uncollected in 1985, and that over the years, billions more have been lost.

RESPONSE:

We acknowledge and have previously testified before this Subcommittee that royalty underpayments do exist and will continue indefinitely to some extent. However, the underpayment figures cited in the article came, unfortunately, from an investigative staff report dated last September and sponsored by this Subcommittee. As I reported to you in September, the figures in that staff report were seriously flawed from both a factual and statistical standpoint. We are still of the view that initial underpayments appear to be more in the range of 3 percent of total royalty receipts. The statement that "billions more have been lost" is unsubstantiated by any source--States, Congress, GAO, the Department's OIG, or MMS auditors.

ASSERTION -- PRODUCT VALUE:

> It would seem, for instance, simple to decide how much a company owes in royalties each year. Just determine the market price on the oil and gas, apply the applicable royalty rate, and send out the bills . . . Last fall Interior finally came up with a surefire way to solve the valuation question: it decided to let Conoco write the guidelines . . . new regulations are no better. If implemented, they would require states and

Indians to rebate millions to oil and gas companies for royalties collected since 1982.

RESPONSE:

This portion of the article incorrectly implies industry and MMS cannot calculate product values, and fails to acknowledge the existence of valuation regulations and guidance which has been used by the Department for several years and are codified in 30 CFR 206 and in Notices to Lessees and Operators. The assertion that Conoco wrote valuation regulations is patently absurd; as proposed, not even Conoco agrees with the draft regulations. Lastly, the article's contention that States and Tribes would be required to "rebate" millions of dollars to oil and gas companies is without foundation. In fact, most companies have disputed NTL-5 findings and have not paid associated royalties, but rather posted bonds or letters of credit since the NTL-5 issue arose.

We are confident our proposed product value regulations will strike a balance between the legitimate financial interests of royalty receipients (States, Tribes and the treasury), and industry equity considerations.

ASSERTION -- RAS RECONCILIATIONS:

Interior's solution? Purge some accounts that had discrepancies . . . But the department naturally opted to wipe the slate clean for only those accounts where the books were off by more than $100,000.

RESPONSE:

We agree with the staff report and Subcommittee's conclusion that pursuing "account reconciliation" was unproductive and not a good use of auditor's time. Unfortunately, The Washington Monthly article again misstates and misuses the facts; the reconciliation effort was abandoned for lease account balances of less (not more) than $100,000. In addition, all Indian lease accounts have been or or being reconciled, without regard for amount. Our rationale for not doing federal lease accounts over $100,000, (in addition to the fact that we were not getting much return on our audit dollar) is that company audits will subsequently cover lease account and royalty payment status more thoroughly than the reconciliation process.

ASSERTION -- LATE PAYMENTS AND INTEREST:

When the agency does collect royalties properly, it doesn't have a conniption about quickly sending Indians and states their share. In 1982 an irritated Congress passed the Federal Oil and Gas Royalty Management Act, which required, in part, that Interior disperse royalties within 30 days of receipt. Needless to say, Interior has not complied with the law. In 1985 thousands of Navajos whose lands are leased for oil and gas production sued the department over late payments. Last July, U.S. District Court Judge Edwin Mechem ruled in the Navajos' favor, saying the department had consistently failed to satisfy the requirements of the law.

RESPONSE:

We have made steady progress in meeting our payment responsibilities to States and Tribes. In FY 1985, for example, our late payment interest liability totaled slightly more than $1,153,000; in FY 1986 it was $316,000. This progress was made in spite of the fact that 93 percent of all payments and reports are received at MMS during the last three days of the month, and monthly payments and explanations of payments are required.

It is also relevent to note that Judge Mechem modified his order in September 1986 to closely parallel our position on requirement for timing of payments under FOGRMA.

ASSERTION -- AFS CONVERSION:

In 1979 Interior began work on a new computer system to track royalty collections and distributions and gave MMS responsibility for overseeing the conversion of data from the existing system to the new computer. Given the importance and complexity of the problem, one might imagine that the MMS would assign as many top-flight people to work on it as possible. Instead . . . the MMS assigned 14 people . . . only three of whom had any experience in converting data from one system to the next . . . The new computer is a dud. To date, Interior has spent $28 million on it, and it still doesn't work properly.

RESPONSE:

In 1979, we did begin work on a new software system to replace the antiquated RAS. This software system is called the Auditing and Financial System (AFS) and was installed on a network of VAX 11-780 minicomputers. Data was not strictly converted from the old system to the new; instead, new lease information was obtained from royalty payors as they were converted.

The author has confused development of AFS with the current effort to convert AFS from the VAX minicomputer configuration to an IBM mainframe.

In fact, RMP's new systems are working as designed ($31 billion has been processed since implementation) And, as is the case with all automated systems, they are undergoing the normal changes and improvements necessary to make them more useful.

Personnel assigned to the conversion team have a total of 45 years of conversion-related experience, hardly an inexperienced group by systems standards. The numbers assigned are in line with the team's job to oversee and monitor the contractor's work, plus perform other functions assigned by MMS.

The new computer certainly cannot be characterized as "a dud" by anyone other than a uninformed person.

ASSERTION -- VAX SYSTEM:

ASSERTION -- INTERIOR'S ACTION ON RECOMMENDATIONS:

Despite years of repeated criticism, the royalty program remains grist for the Borscht belt mill because Interior routinely brushes aside recommendated improvements. . .The reason is simple. There's no financial incentive for Interior to improve collections.

RESPONSE:

Interior (and other Executive Branch Departments) has a number of missions lacking a "financial incentive". And it is generally acknowledged these functions are well-performed, even without the financial motive cited by the author. Rest assured that Interior makes every effort to implement improvements recommended by knowledgeable oversight groups.

For example, since Program inception, nearly 100 improvements regarding royalty program management and operations have been advanced by oversight groups such as the Linowes Commission, Congressional committees, and GAO.

Moreover, in April 1985, the Department evaluated the Royalty Management Program offering 42 of its own recommendations.

Of all these recommendations, 87 have been implemented and another 34 are well in process. Five are contingent on other factors and are on hold at this time. Only the remaining 10 (7 percent) will not be implemented as they have been found to be unlawful, infeasible, or highly impractical.

These figures clearly demonstrate that MMS welcomes and gives serious consideration to all suggestions, whatever the source.

What everyone did understand was that opting for the VAX system had turned out to be a $50 million mistake. It was also a waste of four years.

RESPONSE:

We would be the first to admit that configuring RMP systems on the VAX hardware was a mistake. We recognized that years ago and moved to correct it. However, it is not correct to say that the VAX decision turned out to be a $50 million mistake, and a waste of four years. The $50 million figure approximates the total development costs for AFS and the other two RMP systems, (PAAS and BRASS), as well as the total operations and maintenance costs for all three systems dating back to FY 1981. It is important to note that had the RMP Systems been originally designed and installed on a mainframe computer instead of VAX minicomputers, the primary savings to the Government would have been $8.5 in hardware and system conversion costs. Most of the other costs would have been incurred whether systems were developed on minicomputers or a mainframe computer.

ASSERTION -- MMS DATABASE:

One internal MMS report concedes the agency has "error-ridden files that still have not been completely unraveled or reconciled."

RESPONSE:

The overall royalty error rate has continued to descend and stands at 4.1 percent for February.

MMS operates with two general data files; the information submitted monthly by royalty payors, and our reference data files.

Because of our new information systems, we know that royalty data being reported by industry is more accurate than ever before; if royalties are not reported accurately or on time, we have procedures in place to make monetary assessments against the companies involved and, when appropriate, pursue harsher civil penalties.

Reference data files have been the subject of an intense cleanup project dating back to 1985. Other than BIA Indian leases, pertinent files have been purified. We do have data that have been collected, and that we are not using, and have no plans to use; but we obviously do not intend to cleanup this data.

Senator **Melcher**. Mr. Bettenberg, before we proceed to Mr. Robison, under D of this last chart, appeals and litigation, is that both onshore and offshore?

Mr. **Bettenberg**. That is both onshore and offshore, yes.

Senator **Melcher**. How much of that is offshore?

Mr. **Bettenberg**. I have never seen a figure on how much of that is offshore. I would have to supply that for the record. That is not a category that we have divided it into in the past.

Senator **Melcher**. All of those appeals in litigation have been either oil or gas?

Mr. **Bettenberg**. They can be. Some of them involve coal, but not very many that I recall. It is mostly oil and gas.

Senator **Melcher**. Would you give us also the breakdown between oil and gas as well as the breakdown between onshore and offshore?

[The information follows:]

In response to your request for information concerning appeals to the Director, Minerals Management Service, relating to royalties on Federal or Indian leases the following is provided.

In calendar year 1987 a total of 508 appeals were decided; 279 (55%) related to royalty disputes for Federal oil and gas leases onshore; 142 (28%) related to royalty disputes associated with Federal offshore leases; 84 (17%) related to royalty disputes associated with Indian leases; and 3 (less than 1%) related to royalty disputes associated with Federal onshore leases for minerals other than oil or gas.

Issues addressed in the 508 appeals are categorized as follows:

(32%)	late payment charges	161
(30%)	additional royalties rentals owed*	154
(16%)	late reporting (& nonrespondent)	80
(12%)	erroneous reporting	58
(4%)	refunds	23
(3%)	allowances/deductions	18
(3%)	miscellaneous	14

*includes audits, valuation questions, "take or pay," FERC Order 94, tax reimbursements, etc.

Of the 508 appeals filed in 1987, 46 (8%) were dismissed on procedural grounds (e.g., not timely filed); 65 (12%) were withdrawn by the appellants, or otherwise settled prior to rendering of a decision; 447 (80%) of the appeals were determined by a formal decision. Of these 447 appeals, 20 (4%) were granted; 83 (19%) were granted in part; 25 (6%) were remanded; and 319 (71%) were denied.

Mr. BETTENBERG. In fact, I think we probably cannot break it down by oil and gas because many of them involved both where we are going back on appeal.

We have issued a bill covering a whole series of leases. Those leases might be producing both oil and gas, or the series might have some gas and some oil, and so they are consolidated in a single appeal. But we can give you a breakdown by category, what the issues are, which is the way we evaluate those in our tracking system.

Senator MELCHER. Well, if you have gone from 40, and I think that is what you said; is that right?

Mr. BETTENBERG. Roughly 40 a year, yes.

Senator MELCHER. That was with the USGS, which would involve both onshore and offshore; is that correct?

Mr. BETTENBERG. That is correct.

Senator MELCHER. Now you are at 300 to 500 per year. It seems like a good increase.

Mr. BETTENBERG. Oh, it certainly is. That reflects two things. The first is the fact that we are aggressively pursuing issues with industry, and the second is that we are doing a much larger volume of it than we did in the past.

Senator MELCHER. What do you mean, larger volume?

Mr. BETTENBERG. We have a very large audit staff, for instance, that is pursuing cases. I do not know what the number of auditors was at that time, but it was a relatively small number. We have a 200-person audit staff at this point that is out every day reviewing the books of various companies.

Senator MELCHER. Well, the actual production of oil and gas is not any higher, is it?

Mr. BETTENBERG. Not substantially, no. What you have is a situation where there was not that much work done before 1981 or 1982. We are now pursuing that.

The second area where we have a lot of appeals is on reporting. A lot of reports simply did not come in before. If they did come in, they were incorrect. We follow up on those now.

What those numbers reflect is those companies we have billed and they are unhappy with our billing, so they are protesting. In effect, they are making an appeal thinking that we have been too aggressive one way or another in our operation.

Senator MELCHER. If you've got 100 different cases pending in the Federal courts, please give us what the resolution of those cases has been over the past four years.

Mr. BETTENBERG. Well, those are the ones that are still pending.

Senator MELCHER. I understand that, but over the past four years there must have been some that have gotten to court or you would not have 100 of them now. Some of those must have been resolved, and we would like to know how you resolved them.

Mr. BETTENBERG. Yes. My immediate memory is that I cannot recall losing a case yet between offshore and royalty management. I know that we have won our last 22 cases. We have an excellent winning record.

[The information follows:]

JUDICIAL DECISIONS IN ROYALTY CASES 1985 - 1988

Listed below are the judicial decisions which have been handed down in royalty-related cases from 1985 forward. In summary, of the 20 decisions issued, 19 were favorable to MMS. In the Mesa case (#16), where an unfavorable decision was issued, we have appealed the decision.

It is difficult to say how many appeals are represented by these cases. It is not unusual for several payors whose appeals have been denied to join forces and bring one consolidated case against the Government. Also, MMS may set pending appeals aside while issues are in litigation, knowing that the court's decision will control the policy.

SUPREME COURT

1. Tipperary Refining Co. v. U.S. and DeMenno/Kerdoon v. U.S., ___S.Ct. ___ (1988).
   Denying Tipperary and DeMenno/Kerdoon's petitions for writs of certiorari from 833 F.2d 301 (Fed.Cir. 1987) below.

2. Pawnee v. U.S., ___ S.Ct. ___ (1988).
   Denying Pawnee's petition for writ of certiorari from 830 F.2d 187 (Fed.Cir. 1987) below.

3. Transamerican Natural Gas Corp. v. DOI, 108 S.Ct. 198 (1987).
   Denying Transamerican's petition for writs of certiorari from GHR V. DOI, 816 F.2d (TECA 1987) below.

4. Marathon Oil Co. v. U.S., 107 S.Ct. 1593 (1987).
   Denying Marathon's petition for writ of certiorari from 807 F.2d 759 (9th Cir. 1986) below.

5. Lunday-Thagard Co. v. DOI, 474 U.S. 1055 (1986).
   Denying Lunday-Thagard's petition for writ of certiorari from 773 F.2d 322 (TECA 1985) below.

6. New Mexico v. Baker, 471 U.S. 1065 (1985).
   Denying New Mexico's petition for writ of certiorari from 10th Circuit decision (745 F.2d 1318 (10th Cir. 1984)) holding that the Claims Court and not District Court had jurisdiction over monetary claim by State that U.S. had improperly paid the State's share of onshore revenues from oil leases net of Windfall Profits Tax. (See New Mexico v. U.S. 831 F.2d 265 (Fed.Cir. 1987) below.)

NINTH CIRCUIT

7. Marathon Oil Co. v. U.S., 807 F.2d 352 (9th Cir. 1986), cert. denied, 107 S.Ct. 1593 (1987).
   Affirms the district court of Alaska's entry of summary judgment in favor of DOI. The district court (604 F.Supp. 1375, below) upheld an Interior order on payment of royalty on gas produced from Federal leases in the Kenai Unit, Alaska which was sold as liquefied natural gas in Japan. Motion for rehearing or *en banc* rehearing also denied.

FIFTH CIRCUIT

8. Amoco Production Co. v. Hodel, 815 F.2d 352 (5th Cir. 1987) (Petition for cert. pending, No. 87-372 (S.Ct.)).
   Holding that the Claims Court, not the District Court, has jurisdiction over claims for money refunds in this case involving royalty on gas produced from Federal offshore leases to meet obligations under a warranty contract.

FEDERAL CIRCUIT

9. Tipperary Refining v. U.S. and DeMenno/Kerdoon v. U.S., 833 F.2d 301 (Fed.Cir. 1987), cert. denied, ___ S.Ct. ___ (1988).
   Affirming the decisions of the Claims Court (11 Cl. Ct. 572 (1987)), below.

10. New Mexico v. U.S., 831 F.2d 265 (Fed.Cir. 1987).
    Affirming the decision of the Claims Court (11 Cl. Ct. 429 (1986)), below.

11. Pawnee v. U.S., 830 F.2d 187 (Fed.Cir. 1987), cert. denied, ___ S.Ct. ___ (1988).
    Affirming the Claims Court's dismissal of an Indian complaint concerning gas royalty valuation for failure to state a claim for breach of fiduciary duty.

TEMPORARY EMERGENCY COURT OF APPEALS (TECA)

12. GHR v. DOI, 816 F.2d 689 (TECA 1987), cert. denied, 108 S.Ct. 198 (1987).
    Follows earlier holding in Lunday-Thagard Co. v. DOI, 773 F.2d 322 (TECA 1985), that the Economic Stabilization Act (granting exclusive jurisdiction to the District Court for actions for price control violations) does not waive the sovereign immunity of the U.S.

13. Lunday-Thagard Co. v. DOI, 773 F.2d 322 (TECA 1985).
    Described in previous item.

CLAIMS COURT

14. DeMenno/Kerdoon v. U.S. and Tipperary Rfg. v. U.S., (consol'd), 11 Cl. Ct. 572 (1987).
Granting motion to dismiss for lack of jurisdiction over an overcharge claim under the Economic Stabilization Act. Purchasers of in-kind royalty oil had claimed technical violations of DOE price control regulations.

15. New Mexico v. U.S., 11 Cl. Ct. 429 (1986).
Ruling that windfall profits tax on oil produced from Federal leases is paid before distribution of 50% of net to a State under the Mineral Leasing Act, 30 U.S.C. § 191.

DISTRICT COURTS

16. Mesa Petroleum Corp. v. DOI, 647 F.Supp. 1350 (W.D. La. 1986).
Summary judgment entered against DOI, holding royalty is not due on take-or-pay proceeds. (Appeal pending, No. 87-4069 (5th Cir.), consol'd with Nos. 87-3195 and 87-3207.)

17. Diamond Shamrock Exploration Co. v. Hodel, (consol'd.) Civ. No. 85-0537 (E.D. La. 1987) (unreported).
Summary Judgment entered for the Federal Government ruling that royalty is due on take-or-pay proceeds. (Appeal pending, Nos. 87-3195 and 87-3207 (5th Cir.), consol'd. with Mesa, No. 87-4069.)

18. Coastal Oil and Gas Corp. v. Hodel, Civ. No. 87-C-3345 (D. Utah 1987) (unreported).
Granting the Federal Government's motion to dismiss for failure to exhaust administrative remedies and sustaining the bond-pending-appeal requirement.

19. Crysen Corp. v. DOI, Civ. No. C87-0101 (D. Wyo. 1987).
Granting Federal Government's motion to dismiss for lack of jurisdiction.

20. Marathon Oil Co. v. DOI, 604 F.Supp. 1375 (D. Alaska 1985), aff'd 807 F.2d 759 (9th Cir. 1986), cert. denied 107 S.Ct. 1593 (1987).
Summary judgment entered in DOI's favor sustaining order requiring "netback" valuation method for gas produced from Federal unit in Alaska and sold in Japan as liquefied natural gas.

Senator Melcher. You are represented in court by the Justice Department?

Mr. Bettenberg. Yes.

Senator Melcher. The Lands Division of the Justice Department?

Mr. Bettenberg. The Lands Division; that is my understanding. That is the one that we deal with most typically, yes.

Senator Melcher. When you say you have not lost them, does that mean you have settled some without going to a jury trial?

Mr. Bettenberg. No, those are actual victories in the courtroom.

Senator Melcher. Jury trial?

Mr. Bettenberg. No. The matters in court generally are actions for judicial review under the Administrative Procedure Act or suits for refund in the Claims Court. They are usually handled on legal motions and do not involve jury-triable issues. We have settled some cases but not that many.

Senator Melcher. Perhaps we need to hear from the Lands Division in the Justice Department, too.

Mr. Bettenberg. They are doing a very good job for us, as are the attorneys in the Solicitors office. They do a super job for us.

Senator Melcher. As I recall, the existing statutes are such that you should do a super job because they are loaded on your side. I think that is fair, is it not?

Mr. Bettenberg. The issues are fairly difficult. The last royalty case that I can recall losing is a take-or-pay natural gas case. That is probably a couple of years old now. In one particular case in one district in Louisiana we lost it in a consolidated case involving probably another six companies, and in the other district in Louisiana we won it. That case is before the appeals court right now.

So when you get into product valuation, the issues are not simple.

Senator Melcher. I understand that, and I have a hard time following that myself. That is quite an understatement.

You are charging royalties on take-or-pay contracts. That is one that is before the appellate court, is it not?

Mr. Bettenberg. Pardon?

Senator Melcher. The case that is before the appellate court is because MMS charged royalties on take-or-pay contracts; is that not correct?

Mr. Bettenberg. That is correct, yes. In fact, we have also pursued the same issue in, I think three or four other district courts in other circuits. In that appeals backlog we probably have another, I would guess just offhand, couple dozen take-or-pay cases that are on hold.

Typically, we have agreed with the company that we will await the settlement of the appeals court decision and all be bound by it, for instance. So we have resolved several that way, but we have quite a number of other take-or-pay cases that are sitting on appeal at this point.

Senator Melcher. One of the things that we have to keep in mind is that the success of MMS will also be gauged by the disappearance of the bulk of those appeals in litigation because the system that eventually will be in place will be thoroughly understood.

Then we have the further responsibility here in Congress over the long term to make sure that not only does MMS work, but that it does not tie up production in so many knots of paperwork that people look for other sources of possible investment.

That, I am sure, you understand.

Mr. BETTENBERG. We agree with that sentiment completely.

In the take-or-pay cases, for instance, eventually the courts will settle the issue, and we then hope that no one else will litigate it.

On some sorts of situations, it is my feeling that we are probably approaching the point at which we have had a sufficient number of appeals and a sufficient number of legal decisions that we probably internally ought to look at our processes.

If we have decided the same way 15 times, then maybe we ought to force the companies to go directly to court rather than pursuing the appeals process, for instance.

Senator MELCHER. Thank you.

Mr. Robison.

STATEMENT OF ROLAND G. ROBISON, DEPUTY DIRECTOR, BUREAU OF LAND MANAGEMENT, DEPARTMENT OF THE INTERIOR, ACCOMPANIED BY ROBERT LAWTON, ASSISTANT DIRECTOR FOR ENERGY AND MINERAL RESOURCES

Mr. ROBISON. Thank you, Mr. Chairman. I appreciate the opportunity to appear before this subcommittee today to discuss the Department of the Interior's Royalty Management Program. I have a short statement.

The Bureau of Land Management is responsible for monitoring the production of onshore Federal and Indian leases. Since 1983, BLM has diligently implemented an inspection and enforcement plan known as the I&E program to accomplish the mandate of the Federal Oil and Gas Royalty Management Act of 1982. The I&E program is complex, constantly evolving, and manpower intensive.

In order to carry out a program that is effective, the Bureau has developed and utilizes an I&E strategy plan to prioritize the program objectives within budget and manpower constraints. Although the I&E program includes other responsibilities such as well drilling and abandonment inspections, emphasis is placed on ensuring through production inspections accountability of oil and gas produced and sold from public lands.

The Bureau has an ongoing program to train and certify oil and gas inspectors to ensure quality inspections. To complement this effort, we also actively solicit the participation and cooperation of other agencies in carrying out the I&E program in accordance with FOGRMA requirements.

Because production verification is an integral part of the Royalty Management Program, BLM coordinates activities with the Minerals Management Service and the Bureau of Indian Affairs. A joint steering committee has been established to facilitate cooperation among the agencies.

In 1987 BLM initiated a pilot study on product verification designed to check production accountability as an activity separate from the regular production inspection. Evaluation of the pilot study concluded that leases requiring product verification through actual measurement can be identified through a regular production inspection process. The product verification process, therefore, is now incorporated as part of the overall inspection activity.

The current I&E strategy is to develop a balanced program with emphasis on providing for production accountability on high-producing leases. Criteria have been developed to prioritize for inspection purposes high-producing leases as well as leases with well drilling and abandonment activity.

The strategy calls for three levels of inspection. Level one inspection is an on-the-ground screening process intended to identify whether production is being properly handled, measured and reported and whether operator records agree with BLM's independent observations.

If a concern regarding production accountability is identified, then a level two or level three inspection process will be conducted to verify the actual production.

Level two is a resolution inspection performed in response to problems or concerns identified in the level one inspection.

Level three is a detailed production verification inspection triggered by an anomaly at level one or level two. Level three inspections also are performed on randomly selected leases.

The number of BLM oil and gas inspectors has just about doubled since enactment of FOGRMA, increasing from 60 inspectors to 117. In order to bring the knowledge and skills of the inspectors to the best possible level, we launched an intensive training program for all inspectors. Upon successful completion of an established training program, a person is certified as an inspector qualified to conduct oil and gas inspections for the Bureau. Currently there are 128 certified supervisors and inspectors in the Bureau.

As I said, BLM has actively sought the involvement of other agencies in BLM inspection activities. Regulations to establish delegations of authority to any State under section 205 of FOGRMA for oil and gas inspections and enforcement work have been published. Two States have expressed an interest in this program.

Proposed regulations for cooperative agreements under section 202 of FOGRMA will soon be published. Three cooperative agreements have been established with Indian tribes.

Interaction with other Federal agencies has been ongoing with the establishment of a steering committee composed of representatives from BLM, MMS and the BIA. The committee works to improve coordination and exchange of information among the three agencies in the areas of mineral and royalty management.

BIA is responsible for matters relating to leasing of Indian lands and distribution of lease proceeds to Indian mineral owners. BLM is primarily responsible for leasing of Federal lands, permitting, production plans and conducting inspections on Federal and Indian lands. MMS is responsible for collecting, accounting for and distributing lease proceeds. These broad responsibilities are independent, requiring a high degree of teamwork and coordination to accomplish their separate missions.

In many instances, information collected by one agency is critical to a function performed by another. This was highlighted last June when it was decided to transfer the sole responsibility for the receipt, entry, edit, correction and distribution of onshore production data from BLM to MMS to streamline royalty management. The gradual conversion to automated onshore oil and gas production data is scheduled for completion in Fiscal Year 1989.

The I&E program has been the subject of extensive external investigations as well as internal reviews to ensure the responsibilities enumerated in FOGRMA are being met. The report of the Office of the Inspector General in 1986 and BLM's own internal task force review in 1987 resulted in numerous recommendations that had been or are being implemented.

The essence of these corrective actions is to ensure accountability of oil and gas produced and sold from public lands.

That completes my statement. I should indicate, Mr. Chairman, that I have with me to help supply answers to technical questions Mr. Robert Lawton, who is the Assistant Director for Energy and Mineral Resources in the Bureau.

Thank you.

Senator **MELCHER**. Mr. Robison, when did you join the Department of the Interior?

Mr. **ROBISON**. I joined the Department of the Interior in 1969.

Senator **MELCHER**. You have been with them continuously? Are you career?

Mr. **ROBISON**. I have been with them continuously since that time. You may recall that you and I had a number of meetings going back several years ago over some concerns you had in Montana.

Senator **MELCHER**. Right. I had forgotten, though. That was in 1969, which was virtually 20 years ago.

During this 20 years, you have not always been involved with oil and gas or mineral production, have you?

Mr. **ROBISON**. No. I might say that I was for a time in the Solicitor's Office. When I dealt with you before, it was in that capacity. I have been State Director for the BLM in Utah for the last six years plus, and I came back here in November of last year in this present capacity.

Senator **MELCHER**. Mr. Bettenberg, refresh my memory on your past.

Mr. **BETTENBERG**. I joined the Department in 1964. I am a career employee.

I was with the Bureau of Mines for about seven years, I guess it must have been.

I was in the Office of Secretary involved with the budget business and policy development for roughly a decade.

I was budget director of the Department.

I did a stint as an acting Assistant Secretary for Energy and Minerals when Cecil Andrus first came in while he was seeking a political appointee.

I became the Director of the Minerals Management Service about Christmastime of 1983 shortly after Bill Clark became Secretary.

Senator **MELCHER**. Mr. Richards?

Mr. **RICHARDS**. I have been Inspector General for the past two and a half years at the Department of Interior. Prior to that for about five years I was Inspector General at the Department of Energy.

I am a lawyer by training, and I have been in public practice.

I worked in the Interior Department in another era in the early 1970s as Director of the Office of Hearings and Appeals.

I worked for a Colorado Senator who used to be a member of this full committee back in the 1960s.

I have been in the Department of Justice as an Assistant U.S. Attorney as chief of an organized crime strike force.

Senator MELCHER. Collectively, you have well over a half century of experience.

Mr. BETTENBERG. In the Interior.

Senator MELCHER. So we can expect a resolution of all the problems that are involved over the next year or two, I would hope.

Mr. Robison, have you ever been out in that oil field out of Bakersfield?

Mr. ROBISON. I have not, Mr. Chairman.

Senator MELCHER. Well, I went there one time. I guess it probably would have been 1981, and it was unlike any oil field that I had ever seen with spacing requirements. They were and, I suppose, still are such that you have to ask someone who knows whose well is whose and whether it is Federal, State or private.

The sheriff of that county apprehended at least one truck that had just backed up into a pod and pumped the oil off the surface of the spill pit into his truck and headed for, I suppose, San Pedro to sell it to somebody wanting bunker fuel, some ship wanting bunker fuel.

Now, to overcome that this statute approved in, let us see, it would have been 1983.

When did we approve that? 1983?

Mr. BETTENBERG. FOGRMA was signed in January of 1983, as I recall. I think it is the Federal Oil and Gas Royalty Management Act of 1982, but it was passed——

Senator MELCHER. It was passed in 1982 and was signed into law in 1983.

It required that somebody transporting oil off lease sites would have a document of some nature to indicate whose oil it was.

How has that been working, Mr. Robison?

Mr. ROBISON. Mr. Chairman, with your permission I would like to refer that question to Mr. Lawton, who has much——

Senator MELCHER. Why not take a seat there, Mr. Lawton.

Mr. LAWTON. As part of that program, sir, we have laid out the procedures for the review of run tickets. We can inspect vehicles off site even. Our immediate concern is on site. We have given guidance to the field on that, and it is working. I know of no case where we have had a problem with that.

Senator MELCHER. What does the trucker have in his possession?

Mr. LAWTON. He has the procedures that we go through, but he has the run tickets and all of the identification required—where he obtained the product, whose product it was, a full description of all of the——

Senator MELCHER. Is he required to have that ticket?

Mr. LAWTON. Yes, sir, he is.

Senator MELCHER. He is required, and that seems to be working. How do you know? How do you know he has it? Mr. Lawton: Well, of the inspections that they have had, they have had no violations.

Senator MELCHER. How do you know that the trucker has a run ticket?

Mr. LAWTON. Well, it is required by our procedures.

Senator MELCHER. Do you check it? I guess I should be asking how do you check to know that the driver has a run ticket?

Mr. LAWTON. The inspector on site identifies the vehicle that is on site and he can stop the vehicle and ask for the documentation.

Senator MELCHER. It is at random?

Mr. LAWTON. Yes, sir.

Senator MELCHER. Do you do it offsite?

Mr. LAWTON. We have the authority to do it off site. Off site, we require evidence if there is some question, and we get a local authority to accompany an inspector.

Senator MELCHER. Is that done?

Mr. LAWTON. I do not know that the case has come to that yet, but we have to have some reason to believe——

Senator MELCHER. Probable cause?

Mr. LAWTON. Yes.

Senator MELCHER. In that case you get the sheriff's office?

Mr. LAWTON. The local authority, sheriff's office, State patrol, some local authority.

Senator MELCHER. Now, also at that time in that particular field we saw bypasses. Are there any bypasses now?

Mr. LAWTON. We do not know of any bypasses. We have had, I believe, at least three cases of possible theft involving what we call knowing and willful.

Senator MELCHER. Well, a bypass would be knowing and willful.

Mr. LAWTON. That is why they are in this category. When we find evidence of such an activity, we turn it over to the proper authorities, either the local authorities, FBI, or our own law officials. If it is taken up by those officials at that time, we do not pursue it. We let them do it.

Of the cases that we have had——

Senator MELCHER. Now, wait a minute. You have the authority, do you not? You have plenty of authority.

Mr. LAWTON. We have the authority, but we turn it over to officials, either the Bureau's officials, the FBI—and it depends on the situation.

Senator MELCHER. What do you mean by "the Bureau's officials"?

Mr. LAWTON. We have our own law enforcement people.

Senator MELCHER. Well, tracing the production through, what are those devices that measure the production of oil out of a well?

Mr. LAWTON. We have several devices. Actually, there is the manual gauging. We have the meters.

Senator MELCHER. What are those meters called; just meters?

Mr. LAWTON. There are several types: the regular orifice meters, and the lease account transfer meters.

Senator MELCHER. Well, that is pretty basic. The bypasses that I saw, of course, were not hidden or I would not have seen them. But that is exactly what your inspection does, is it not; traces the oil from where it starts and how it is measured?

Mr. LAWTON. Yes, sir, and this is one of the inspection actions taken in which we look for any bypass or irregularities in the transfer configuration.

Now, as I mentioned, the one where we found evidence that we thought was a specific bypass situation, we turned over to the proper authorities. Just recently I heard that the U.S. Attorney has not gone forward with the prosecution of the situation. They indicated it was a small amount, but that is all that I know about it.

Senator MELCHER. Mr. Robison traced how many inspectors you had. I think it is something like 60.

Mr. LAWTON. We have 117 right now.

Senator MELCHER. You previously had 60, and now you have 117.

Mr. LAWTON. When the Bureau of Land Management took over this responsibility of the total operations from the Minerals Management Service in April of 1983, at that time we did have about 60 inspectors.

Senator MELCHER. How many of them were from USGS?

Mr. LAWTON. All of them came from the USGS or Minerals Management.

Senator MELCHER. What is the pay?

Mr. LAWTON. Most of our regular inspectors are at the 4 and 5 level. As they progress into supervisors, they can go up, I believe, as high as GS-11.

Senator MELCHER. There has been a problem over the past six years in recruiting, has there not?

Mr. LAWTON. There has been a major problem in keeping the people, yes, sir.

Senator MELCHER. In keeping them or getting them?

Mr. LAWTON. In keeping them. Recruiting them is not too much of a problem. The training program that we have now, we think, is very good on the exploration, the drilling and the production side. It has been difficult to keep the people.

Senator MELCHER. How many inspectors are in the field right now?

Mr. LAWTON. The 117 is a total number.

Senator MELCHER. In the field?

Mr. LAWTON. Yes.

Senator MELCHER. How many Federal leases are there?

Mr. LAWTON. You mean producing leases?

Senator MELCHER. Yes.

Mr. LAWTON. Both Indian and Federal, we have about 24,000. About 4,500 of those are producing Indian leases.

Senator MELCHER. Producing on Indian lands?

Mr. LAWTON. Yes.

Senator MELCHER. So 21,000?

Mr. LAWTON. About 24,000.

Senator MELCHER. So about 20,000 in Federal leases?

Mr. LAWTON. It fluctuates because there are shut in and nonproducing wells, abandonments of an entire field. It runs in the area of around 18,000 usually.

Senator MELCHER. I believe the statute says that you ought to inspect all these producing fields once a year; is that right?

Mr. **Lawton**. The major ones—and we classify major as high priority—are those that produce 3,000 barrels of oil per month or 30,000 mcf of gas per month. That is not too great a volume, and when you figure it is on a per-lease basis, on a communitized agreement or a participating area of a unit, it comes down to about 100 barrels a day for whatever that measurement unit is.

Senator **Melcher**. How many of those are there?

Mr. **Lawton**. We have about 3,500 of those in the major category.

Senator **Melcher**. 3,500 leases?

Mr. **Lawton**. No. It would either be a lease, a communitized unit or a participating area of a producing unit. It can include one well or several wells within that configuration.

Senator **Melcher**. Well, can 116 or 117 inspectors be expected to get to each of those once a year?

Mr. **Lawton**. Yes. We feel that not only can that be dome, but we have a requirement that the others, the lower priorities, are inspected at least every three years. Yes, we are on those, and we think with the staff that we have we are capable of inspecting them.

Senator **Melcher**. Is it true that inspectors are spending most of their time doing administrative and clerical duty rather than being out in the field?

Mr. **Lawton**. No, sir. When we first took over this responsibility, one of the problems we were confronted with was the fact that we did not have adequate support for the inspectors, the cartographic work, the clerical work. We found that the inspectors were taking a considerable amount of their time doing these other tasks.

This has been corrected and the majority of their time now is in the field and on the ground. They have the proper administrative support that we feel a distribution of their time is proper.

Senator **Melcher**. Well, during the last six years, of course, the oil patch has been a pretty dismal place to be with the decline of oil prices. I would assume that in some respects that would make it easier to recruit experienced people for inspection work. Is that true?

Mr. **Lawton**. Yes, sir. It has been true not only for our inspection enforcement people but our petroleum engineers also.

Senator **Melcher**. Mr. Bettenberg, how much money was spent on the computer system that had to be scrapped?

Mr. **Bettenberg**. Well, let us see. There are a lot of different ways of counting that. For the computers themselves, I am advised that had we gone directly to a mainframe computer the actual cost that would have been saved is something in the neighborhood of maybe $5 million or so.

Senator **Melcher**. How much?

Mr. **Bettenberg**. About $5 million or so saved. It seems to me at one time I saw a figure quoted of $60 or $70 million. That was a figure that, as best as we could tell, had been completely fabricated.

Senator **Melcher**. How much? How much was fabricated?

Mr. **Bettenberg**. That figure appeared to have been completely fabricated.

Senator **Melcher**. What was that figure?

Mr. **Bettenberg**. We thought that the actual cost probably, as I recall, something a little less than $50 million, but that included the cost not only of developing the fiscal accounting system but the production accounting system, the bonus rental accounting system, the other systems that we have, and actually running them for a number of years.

You need to remember that these systems, the AFS for instance, just since it has been in place, has been accounting for $3.5 billion a year. That is for, I guess, all of 1984, 1985, 1986 and 1987 when it was operating in the mini-computer environment.

When I give you those figures, they are not intended to mask what I consider to have been an extremely poor decision, the decision to originally implement that system on mini-computers.

That decision was made by the Geological Survey in 1981, and it was a very poor decision. It was not a good operating environment for this system. It effectively threw the royalty collection system into a crisis mode for the first several years that it was operating. When I came on board around the first of 1984, it was touch and go every single month as to whether they would be able to process the workload that had come in that month. If they ever got behind, it was questionable that they could make it up.

The system was spread among three VAX mini-computers that could only be synchronized once a week. It was a system that was essentially being held together with bailing wire, and it took us several years to work out of that.

Senator **Melcher**. Well, during that time when you were on mini-computers, was there evidence to indicate that you were not collecting all of the royalties?

Mr. **Bettenberg**. There was substantial evidence of that before they went to the new computers. That is what all of the fuss was about originally. The GAO reports, the internal reports, the Linowes Commission report—I wrote a memorandum or a report, and I do not recall which, back in 1981 that said that the Conservation Division was essentially a bankrupt organization and needed to be put into receivership, which is precisely what was done at the beginning of 1982.

During the early going of the fiscal accounting system, AFS, input error rates were running very typically something in the neighborhood of 40 percent, reflecting the fact that much of the data in the system were erroneous, that a lot of people were not reporting, and when they were reporting they were reporting incorrectly.

In the last couple of months we have been running at about 3 percent input error rate on reports received from industry, which we consider to be extremely good, but it has taken a Herculean effort, if you will, to get it to that point.

Senator **Melcher**. You went to an IBM mainframe computer system, did you not?

Mr. **Bettenberg**. That's correct.

Senator **Melcher**. Then you contracted with Martin Marietta?

Mr. **Bettenberg**. We contracted with Martin Marietta to take the system as it was operating on VAX mini-computers and convert it so that it could be run on an IBM mainframe computer and to supply that mainframe computer. It was all one process. We awarded that contract in April of 1985, and they completed the job in September of 1987.

Senator MELCHER. During that period of time, 1985 to 1987, the Department had a dispute with the payment to Martin Marietta; is that right?

Mr. BETTENBERG. That is correct, yes.

Senator MELCHER. What were the terms of the settlement with Martin Marietta?

Mr. BETTENBERG. I may need some help on the precise terms, but basically they were late in terms of implementing the system—converting it. We had a provision where we could deduct liquidated damages against what we owed them.

At the same time, they had a series of claims totaling $7 million for what they considered to be additional work that was out of the scope of the contract. As I recall, that was eventually settled for I think it was something like $1.1 or $1.2 million.

Senator MELCHER. Who got the money?

Mr. BETTENBERG. They got the money in the settlement. We had withheld about $1 million through liquidated damages. They had claims for change orders and that sort of thing that totaled something over $2 million, and essentially we settled for about one-third of the total dispute between them and us.

Senator MELCHER. Who made the decision on that settlement?

Mr. BETTENBERG. That would have been the contracting officer reviewing the documentation.

Senator MELCHER. Who signed off on it? You?

Mr. BETTENBERG. No, that would be have been our contracting officer.

Senator MELCHER. Which Assistant Secretary signed off?

Mr. BETTENBERG. No Assistant Secretary would have signed off on that.

Senator MELCHER. You mean it just went to the contracting officer who settled the whole thing?

Mr. BETTENBERG. Our contracting officer settles claims all of the time.

Senator MELCHER. Well, I do not know whether you would call that a win or a loss.

Mr. BETTENBERG. That was a tough decision. We had many discussions which included management personnel, myself, and our Assistant Secretary.

Senator MELCHER. Tell me this if you can. During this period of time were you getting complaints from States and Indian tribes that you really were not collecting all the royalties?

Mr. BETTENBERG. On occasion we had that kind of complaint. However, the typical complaint was either that the information we were supplying was not as good as it might be; that a payment was delayed. (Some payments are delayed because we do not have the data to disburse the money.)

Senator MELCHER. If there were some complaints but they were just that, complaints, nothing ever came of it, then you got involved in these court cases that you have over here?

Mr. BETTENBERG. No. Some of those court cases probably involve money in the sense that a State may have done the audit work for us or we may have done the audit work if it was onshore.

We have spent a lot of time with the State representatives that we deal with and the Indians. We meet quarterly with them on a regular basis. We meet more frequently on an individual basis. We have an entire organization that we set up to deal with them in the fall of 1984 and in the case of Indians a separate unit to deal with the allottee cases that we set up in 1985.

Many of the complaints that have been lodged with us have been very legitimate complaints and involved us trying to find out what the facts were in the situation and dealing with it. They were both systemic kinds of problems as well as individual case problems, such as a particular company had not paid as much as somebody else thought they should have.

Senator **Melcher**. Regarding this dispute over the effectiveness of the so-called mini-computer system versus the mainframe system, is it true that the mainframe system collects more royalties?

Mr. **Bettenberg**. The mainframe collects more royalties? I do not know that we could allege that. We have thought that there probably would be some kind of a benefit in that regard. I am not sure that we can quantify it.

Let me back up. The system that is running is the identical system in all important respects to the one that was running on mini-computers. The system was not improved in the sense that software routines produce better reports and that sort of thing. We have a fair amount of work still ahead of us for upgrading the system to the standards that we have concluded that we needed to upgrade it to.

But it does do a couple of things that are extremely helpful. The first is that in the mini-computer environment you could not function effectively in an online capacity for error correction and that sort of thing, whereas in the main frame environment you can do that. So it is a lot simpler to get on, correct errors, get back off the computer.

I noticed that our exception processing revenues jumped very substantially during the first three months that we were on the mainframe computer, and that was simply because there were a lot more actions that could be processed from a timing standpoint.

So the revenue went up from that standpoint during that period as they were getting more current with the system. It is a much, much better operating environment for the system, and it is very important that we are on it.

Senator **Melcher**. You spent $32 million to convert, is that correct?

Mr. **Bettenberg**. That is not correct.

Senator **Melcher**. What did it cost to convert to mainframe?

Mr. **Bettenberg**. The total expenditure over several years was around $20 million. The conversion contract was, as I recall, around $4.4 or $4.5 million. The contractor was also responsible for running the machine and doing operations. Supplying a computer was a part of the $20 million cost.

The $30 million that you mentioned was total scope of contract as originally awarded and included exercising all options, several of which we did not exercise, such as the options to convert the BRASS system or the production accounting system. It also involved actually operating the system, operating the computer when it was being tested, when the system conversion was being tested and so forth. It involved a number of things.

Senator MELCHER. Just so I understand this, this was the contract with Martin Marietta, was it not?

Mr. BETTENBERG. It was, yes.

Senator MELCHER. It might have totaled around $30 million if you had exercised all the options; is that correct?

Mr. BETTENBERG. That is correct, which we did not do.

Senator MELCHER. So the total contract was around $20 million?

Mr. BETTENBERG. The total contract was around $20 million, of which the portion that involved converting the AFS system from mini-computer to the mainframe was around $4.4 million, as I recall.

Senator MELCHER. Was it the $4.4 million or the $20 million with Martin Marietta, a portion of which was in dispute?

Mr. BETTENBERG. It was the $4.4 million.

Senator MELCHER. It was $4.4 million, and a portion of that was in dispute, Martin Marietta wanting somewhere near $5 or $6 million, and you settled that for somewhere a little over $4 million. Is that correct?

Mr. BETTENBERG. A little over $4 million, that is correct.

Senator MELCHER. Let me ask you another question. Does the Department make electronic transfer funds to the tribes and the States?

Mr. BETTENBERG. Just one second. Let me check that.

[Pause.]

I am advised that the payments to States are by electronic fund transfer. The payment to tribes is made by the Bureau of Indian Affairs. We transfer the money from our account into BIA's account.

Senator MELCHER. Then they break it down for all the allottees?

Mr. BETTENBERG. That is correct. Something like roughly 90 percent of the payments that we get are by electronic fund transfer as well as from industry.

Senator MELCHER. It seems to me that what we expected out of MMS was an audit report that was pretty comprehensive, but I think you have just testified that something less than 2 percent of all the leases during Fiscal Years 1986 and 1987 were audited. Did we understand you correctly on that?

Mr. BETTENBERG. That is what Mr. Richards had indicated.

Senator MELCHER. I thought you verified it.

Mr. BETTENBERG. I have not seen the comparable number.

The audit operation during the early years, the larger share of that was devoted to what was considered to be the mandatory workload. You will recall that FOGRMA required that we reconcile accounts, and so a tremendous effort was put into that. That was essentially completed at the end of Fiscal Year 1986.

In 1983 and probably into 1984 a lot of auditors were pulled off to help with the conversion of the various offices as they were going onto the mini-computers from the old royalty accounting system.

A lot of effort has gone into the audits of refunds. A lot of effort has gone into requests by individual Indians or tribes for specific audits of their effort. The result of that is that not nearly as much effort as we would have liked went into what we considered to be comprehensive auditing.

On the other hand, a lot of money came in through that channel, as I testified earlier. By the end of last fiscal year we were well along towards freeing up those audit resources and had something like 70 comprehensive company audits under way at that time. We have something, I think, upwards of that number in process right now as well. Some get completed and so forth.

We have been in the process of implementing a new audit strategy over maybe the last year and a half or so, and as a result of all of that I signed off on a strategy document for an audit program in early April.

Senator MELCHER. Of this year?

Mr. BETTENBERG. Of this year. It devotes 60 plus percent of our audit resources to comprehensive audit.

Senator MELCHER. Do you have enough resources?

Mr. Bettenberg. Our audit staff advises me that we do, that they can audit essentially the lease universe under the audit strategy on a six-year cycle. What that involves——

Senator MELCHER. Approximately what?

Mr. BETTENBERG. On approximately a six-year cycle.

Senator MELCHER. What would you audit during that six-year cycle? Did you mention a percentage?

Mr. BETTENBERG. I did not mention a percentage.

Senator MELCHER. How much would you audit during that six-year cycle?

Mr. BETTENBERG. Let me ask Mr. Moyers to come on up.

I am told that the major company audits and the resident audits that we have covered about 95 percent of the money, and the remaining 5 percent would be covered through a sampling program essentially. You would not necessarily hit every single company in that process.

Senator MELCHER. Over six years you would audit 95 percent of the leases?

Mr. BETTENBERG. You would audit 95 percent of the companies.

Senator MELCHER. That is going to translate into approximately 95 percent of the leases, is it not?

Mr. MOYERS. I think it would be somewhat less. A percentage of the leases is probably 75 to 85 percent.

Senator MELCHER. 75 to 85 percent of what you would call producing leases of significance?

Mr. MOYERS. Yes.

Senator MELCHER. I do not quite understand how you can get 95 percent of the companies.

Mr. BETTENBERG. I probably misspoke. I meant 95 percent of the revenues, not 95 percent of the companies. So I think it is something——

Mr. MOYERS. A little over 200 companies. On the basis of 1986 data, which is the way we planned this, we would cover about 220 companies plus our 13 resident companies, which are the majors, the Exxon and Texaco types.

Senator MELCHER. Are there three tribes who are participating in the inspection in cooperative agreement, Mr. Robison? Is that what you said?

Mr. ROBISON. I think that was two.

Senator MELCHER. I think it was three tribes and two states that showed some interest; is that correct?

Mr. LAWTON. Under 202 of FOGRMA, which covers the cooperative agreements with the Indians, we have one signed agreement with the Ute Mountain Tribe. We have two tripartite agreements. They are not adhered to specifically, but they contribute funds. There are two other agreements that we are working on and two others that——

Senator MELCHER. Those are all tribes?

Mr. LAWTON. All tribes. Under section 205 of FOGRMA, which covers the delegation to the States, there is none.

Senator MELCHER. Which tribes are they? You have a working agreement with the Ute Mountain Tribe?

Mr. LAWTON. We have an agreement with the Ute Mountain; we have a tripartite agreement with the Jicarilla Apache; and I believe the other one is the Navajo Tribe.

Senator MELCHER. Does the Ute Mountain Tribe have much production?

Mr. LAWTON. They have, I believe, 38 producing leases.

Senator MELCHER. Just 38?

Mr. LAWTON. Yes.

Senator MELCHER. Now, the Jicarilla Hickory Apache would have a lot more than that; right?

Mr. LAWTON. Yes, sir.

Senator MELCHER. They independently started an inspection service of some consequence prior to this cooperative agreement, did they not?

Mr. LAWTON. Yes. We trained inspectors for the individual tribes, and they did some inspecting.

Senator MELCHER. Did they have an ongoing inspection of their own prior to 1983?

Mr. LAWTON. That I do not know, sir. We would have to furnish that for the record.

Senator MELCHER. I wish you would.

I also wish you would give us a little comparison of what the tribes do, you know, the Ute Mountain Tribe with 38 producing wells, which is a very small number of wells, how many inspectors they have for that in their cooperative agreement; and then the Jicarilla Apache, how many inspectors they have and how many producing wells they have.

[The information follows:]

According to our information the Jicarella Apache tribe did not have an independent ongoing inspection activity of its own prior to 1983.

With regard to the Jicarilla Apache Tribe, there are currently 143 producing oil and gas leases. The Tribe has no employees dedicated fully to inspection oil and gas lease activity.

With regard to the Ute Mountain Tribe, BLM is currently training one Tribal employee to inpsect oil and gas lease activities. It is anticipated that this person will be certified by the end of fiscal year 1988. However, it is our understanding that this individual will not dedicate 100 percen of his time to oil and gas lease inspections and that BLM employees also will perform inspections on Tribal lands.

Senator **Melcher**. I am of the opinion that going from 60 to 116 or 117 inspectors—which was it?

Mr. **Robison**. 117.

Senator **Melcher**. I am of the opinion that going from 60 to 117 is probably not adequate, but it was my clear understanding that whatever you thought was necessary would be provided by Interior in their funding request each fiscal year. Is that not right, Mr. Robison?

Mr. **Robison**. That would be correct.

Senator **Melcher**. That is correct.

Now, Mr. Bettenberg, is that not also correct in your situation with MMS? Whatever you feel is necessary to thoroughly do the job at Interior is accepted by the Secretary and is therefore translated into the funding request; is that not right?

Mr. **Bettenberg**. I think that is essentially correct, yes. We have not been denied the resources that we felt we needed.

Senator **Melcher**. Now, Mr. Richards, your reports indicate that you are not satisfied at all with the auditing system in the program that was just formulated last month and that you signed off on last week and which Mr. Bettenberg has described.

What did you call it, Mr. Bettenberg, an auditing strategy program? Is that right? Is that how you described it, Mr. Bettenberg?

Mr. **Bettenberg**. What I described is an audit strategy. It is a strategy that was essentially implemented last year.

Senator **Melcher**. You are not satisfied with it, are you, Mr. Richards?

Mr. **Richards**. Well, until recently here we have been pressing MMS to come up with a comprehensive audit plan. They had a strategy which we saw early this year and which they issued in April which had many of the elements of an audit plan.

But an audit plan is a comprehensive document. It says here are our resources. Here is our universe, our lease inventory. Here is how we are going to apply those resources to this inventory so that we can audit essentially every one of these leases or cover all of the revenues, the majority of the revenues over a period of six years, because six years is how long the oil companies have to keep the records.

Recently they have now from the audit strategy gone to a rather comprehensive document which we have just obtained from them recently which is beginning to look like a comprehensive audit plan committing 100 percent of their resources to their inventory and assigning which auditors will do which audits, what the scope and objective of those audits will be, what the benefits are expected to be, what kind of samples they will do; in other words, a comprehensive look at the audit universe so that they know that they will cover all of those leases and payors over a six-year period.

Senator **Melcher**. Mr. Bettenberg, you just put this together last week, did you not? I know it took you longer than that to prepare it, but it just really got put together last week, did it not?

Mr. **Bettenberg**. What we are calling an audit plan, yes. We have no objection to writing this down and giving it to the Inspector General. The opinion of our audit staff was that they were effectively working on that and had all the pieces of that together well before now. But in response to their report, it was written down in a document and provided to them.

Senator **Melcher**. You audited less than 2 percent of the leases in Fiscal Years 1986 and 1987, and what did you audit in Fiscal Year 1988?

Mr. **Bettenberg**. What they said was that we had not comprehensively audited. That is the qualifying word there. We had audited thousands and thousands of leases during that period, but some of those audits were focusing on one kind of a payment or some other kind of a payment.

The key word there is that they favor a comprehensive audit of a company.

Senator **Melcher**. Well, what is that key word? What is comprehensive?

Mr. **Bettenberg**. Let me refer to Mr. Moyers to cover that for you.

Mr. **Moyers**. Our definition of a comprehensive audit of a company is that it actually takes in the company's business systems or the way they run their own business. We review their accounting systems, their production systems, all of the systems either manual or automated that they utilize to collect and process and report to the Department both production and royalty data.

We look at those systems to see if they have the proper internal controls, et cetera. Once we are fairly happy with them, we select leases of varying types, various onshore leases, offshore leases, Indian tribal and allotted leases, to then trace those and test those through the system to come to the final answer of whether royalties have been properly paid.

Mr. **Bettenberg**. If I could supplement that, the kind of work that our auditors have previously done typically was not that comprehensive. For instance, substantial effort went on in the early years on the reconciliation effort which was mandated in law in FOGRMA.

The OCS Lands Act requires that certain certifications come with refunds for outer continental shelf leases, so a substantial effort was put into that. That turned into a lot of money. It resulted in us refusing many refunds. Those specific leases which involved those refunds were audited for that purpose, but it was not a comprehensive audit of the company on all issues.

Take-or-pay cases involved a substantial amount of money. You could go into a company and audit for all of their take-or-pay payments, but that would not mean that you audited for every other single thing that the company did.

The result of all of that, as I indicated before, is some $429 million in the till. We cannot guarantee that comprehensive audits would have resulted in any more because you might have covered a smaller part of the lease universe.

We have another $200 million plus that is on appeal and bonded in terms of audit finding.

On the other hand, we do not disagree that that is the best long-term approach to take, and as resources have been being freed up, we have been converting people to do comprehensive audits.

To give you a specific example of a noncomprehensive audit, a particular tribe or allottee comes in and says we would like you to audit our lease. We typically do that if it looks like it could use auditing. That is not a comprehensive audit because it is not comprehensively auditing the company. It is comprehensively auditing that lease.

Senator MELCHER. I am reading the statute. In 1711, chapter 30, "the Secretary shall establish a comprehensive inspection, collection and fiscal and production accounting and auditing system to provide the capability to accurately determine oil and gas royalties, interests, fines, penalties, fees, deposits and other payments owed and to collect and account for such amounts in a timely manner."

Mr. Richards, when you say comprehensive, are you talking about what Mr. Bettenberg is talking about? He says he has to look at the company and determine how the company does all of this, I guess assuming that the company also produces off of non-Indian, non-Federal leases.

Mr. RICHARDS. Here is what we are talking about, Mr. Chairman. Comprehensive auditing are the kinds of audits that were done in the look-back audits that were recommended by the Linowes Commission. We did 34 of the top 50 payors and 10 of the next 50 payors and 10 of the gas processing plants.

In those comprehensive audits, which were accurately described as looking at the accounting system, looking at production, looking at sales and the royalty payment, we identified about $160 million of potential underpayments. I say potential underpayments because of the lack of good valuation guidance and some of these legal issues that were described such as take-or-pay or the FERC orders; $58 million of that was collected by MMS. That is an example of what you can do with comprehensive audits.

What MMS was doing here in Fiscal Years 1986 and 1987, and we went back and looked at the workpapers of their auditors to find out what they were doing, they were only expending 2 percent of their audit resource, doing those kinds of comprehensive audits. They were spending 38 percent of their time doing refunds.

You do not collect money doing refunds. You may deny refund requests, but you do not collect money doing refunds. Refunds could be done in the process of doing a comprehensive audit. It is true that there are some single issue audits that the MMS auditors have to do. They do have an adequate auditing system, as the statute requires.

What we were criticizing them for and what we were disappointed in was the way they were using the auditors, not to do comprehensive audits but to do single issue audits. We thought they could be a lot more productive.

It was contemplated that this audit resource would be used in the residencies, particularly at major payors to do comprehensive auditing.

Senator MELCHER. The term "comprehensive" is in the statute. That is not a term that the Secretary thought of or Mr. Richards thought of at the Inspector General's Office. That is what was deliberately placed in section 1711.

It seems to me that what you are now describing, both you, Mr. Bettenberg, and Mr. Richards, is as Congress thought it should be done, not what came as an afterthought.

It seems to me that it has taken a long time to get to this point. This is 1988 and, using your word, Mr. Bettenberg, of strategy, you have just translated that into an actual plan, so perhaps we are getting there.

I do not want to dwell on this any longer, but it seems to me it has taken an awful long time to get there, since that is what was required.

I have one question more dealing with drainage that may lead to a discussion between the three of you. Surely drainage potential is rather obvious.

Is that not right, Mr. Robison?

Mr. ROBISON. Drainage is, of course, a concern, Mr. Chairman, yes.

Senator MELCHER. It is a concern, but there could be a drainage problem. It is obvious, is it not? You have the lease here and you have somebody producing out there. That is pretty obvious that there might be a drainage problem.

Mr. ROBISON. Well, sometimes it may be obvious, and sometimes it may not.

Senator MELCHER. I mean, where you want to see if there is drainage potential, the circumstances are obvious, are they not? It is that simple. You have production off of the Federal lease and an adjoining private lease. It could be the lease of the same company or a different company that is on private land.

So that is pretty obvious, is it not?

Mr. ROBISON. Those areas of potential drainage problems—yes, sir, I would think—would be readily pinpointed.

Senator MELCHER. Well, the IG looked at this, and I do not think the Inspector General ever gets around to looking at everything. One of his reports stated that as much as $4.8 million in royalties has been or could be lost due to inadequate engineering and economic analysis on certain cases reviewed by the IG.

What is your estimate of this loss by drainage? Do you have any? Can you tell me in how many instances you are looking at the potential for drainage?

Mr. LAWTON. Under the procedures that we have now, we do inspections on an annual basis. We look at all of the wells drilled on and around Federal leases.

Probably there are as many as 40,000 wells drilled that we evaluate. Of this number, there are possibly 2,000 to 2,500 wells that could possibly be drainage situations. Usually that boils down to about 250 wells that really require close scrutiny to see if there is a drainage situation.

Now, the procedures that we have developed on this will give better guidance to both the operator and to our people; that is, we are looking at the prudent-man theory as to whether a person would drill a well to prevent the drainage.

Early on, it is my understanding when it was required that a well be drilled, often it would be a dry hole because the potential for drainage was there, but it would not justify the expenditure of the cost of the well.

Under the procedures we have now, we can cause an operator to drill an offset well or, in the event that it is determined that the cost would be too great to justify drilling, then the operator can pay compensatory royalty to the Federal Government as though the well were produced. We would then get the compensation for the oil which is being drained.

Senator **MELCHER**. I am looking at the IG report. It states that, "None of the 15 offices we visited that were responsible for drainage protection had an adequate program because the drainage protection program would give it a low priority. Less than 2 percent of the 898 staff years charged to fuel mineral operations for those 15 offices were personnel devoted to drainage."

I also garner from this report that there is a backlog of 53 staff years, and you state, Mr. Robison, that this has been improved.

Just how has it improved? Do you have more people looking at it, or what are you doing?

Mr. **LAWTON**. We have done several things. We have in fact made drainage a high priority within the Bureau.

We have changed the procedures and the guidelines for drainage. In fact, one of our first steps was to change the organization of our Washington office to establish a division for Reservoir Management, which includes drainage. Under that division we have also placed inspection and enforcement. It is all in one group now.

We have established a task force for policy to develop the guidance and procedures for the field. This group is an ongoing body that is looking at how to improve the procedures, how we can better do the work.

We are going to an automated mapping system whereby we put all of the proper information, well histories, well data, into an automated system that will allow us to develop an automated map of the reservoir.

Senator **MELCHER**. All right. That is, again, sort of a plan or a strategy. It will be a plan when it is carried out, I guess.

But there are 53 staff years backlog in the drainage program; do you agree with that?

Mr. **LAWTON**. I think that was the figure they came up with—that there were about 8,400, as I recall, drainage situations. I think we are closer to a backlog of 4,000 of those specific areas that we have to examine.

So I think we are much better off than the cited 53 staff years.

Senator **MELCHER**. How did you come up with that figure, Mr. Richards, of 53 staff years backlog?

Mr. **RICHARDS**. We counted the drainage cases that were backlogged, calculated what the average time staff required to do a drainage case, and translated it into staff years.

Senator **MELCHER**. This is the third time I am going to make this point; that is, it is my understanding and you have so testified, Mr. Bettenberg and Mr. Robison, that when you show the need for staff that it becomes the Secretary's request and that you have no problem with getting the funds because the Secretary reviews what you ask for and allows it. I do not think Congress has been denying you anything on this, or have we?

Have you been getting your full request in these categories budgetwise?

Mr. **LAWTON**. Yes, sir. In the Bureau's budget, we have.

Senator **MELCHER**. Mr. Bettenberg?

Mr. **BETTENBERG**. Yes, we have done well by Congress.

Senator **Melcher**. So we seem to be working together.

How did you get your appointment, Mr. Richards? Through the Secretary?

Mr. **Richards**. The President.

Senator **Melcher**. Through the President. So we are all on the same side, it appears. I would hope that we are going to resolve these problems.

Now, as I announced earlier, this is just the first hearing. We will hear from the companies; we will hear from the tribes; we will hear from the states and whoever else wants to tell us something.

The amounts of money we have been talking about are rather small compared to the amounts that have been discussed in some newspaper items which estimated losses at up to $2 billion just for Indians.

Now, we will get everybody's viewpoint and try to identify the true circumstances.

Mr. **Bettenberg**. Mr. Chairman, if I could make one comment on your last remark. I do not recall having seen a $2 billion figure on Indians, but I am advised that our auditors have reviewed some 1,700 Indian leases. That is out of a universe of roughly 4,500, I think it is. We have come up with additional payments of about $15 million.

Senator **Melcher**. I know, which is altogether different.

Mr. **Bettenberg**. So it is a very different order of magnitude.

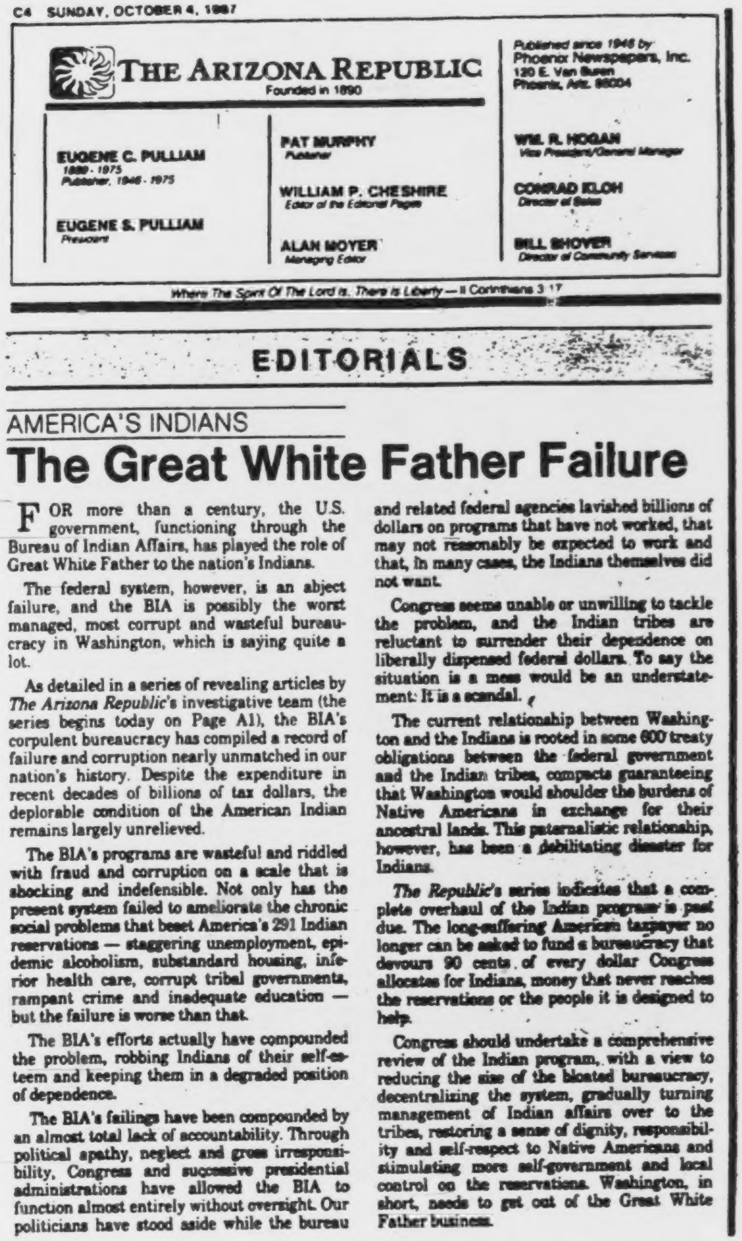
Senator **Melcher**. There have been some rather high figures thrown around. Let me give you one that the Arizona Republic had. I do not know what date this is.

Under the Freedom of Information Act, the Arizona Republic says it shows that misfeasance has deprived Indians and the Federal Government of possibly $5.7 billion in oil royalties.

Mr. **Bettenberg**. I think that they did not present any evidence to support that, though. We have included as a part of our response a response that we provided to the Arizona Republic. They refused to publish it.

Senator **Melcher**. You made some reference in your testimony, Mr. Bettenberg, that is your written testimony, to copies of the Arizona Republic articles and the Tulsa Tribune article, at least one article from the Tulsa Tribune. So if you would supply those to us for the record, we would appreciate it.

[The information follows:]



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Where The Spirit Of The Lord Is, There Is Liberty — II Corinthians 3:17

EDITORIALS

AMERICA'S INDIANS

The Great White Father Failure

FOR more than a century, the U.S. government, functioning through the Bureau of Indian Affairs, has played the role of Great White Father to the nation's Indians.

The federal system, however, is an abject failure, and the BIA is possibly the worst managed, most corrupt and wasteful bureaucracy in Washington, which is saying quite a lot.

As detailed in a series of revealing articles by *The Arizona Republic*'s investigative team (the series begins today on Page A1), the BIA's corpulent bureaucracy has compiled a record of failure and corruption nearly unmatched in our nation's history. Despite the expenditure in recent decades of billions of tax dollars, the deplorable condition of the American Indian remains largely unrelieved.

The BIA's programs are wasteful and riddled with fraud and corruption on a scale that is shocking and indefensible. Not only has the present system failed to ameliorate the chronic social problems that beset America's 291 Indian reservations — staggering unemployment, epidemic alcoholism, substandard housing, inferior health care, corrupt tribal governments, rampant crime and inadequate education — but the failure is worse than that.

The BIA's efforts actually have compounded the problem, robbing Indians of their self-esteem and keeping them in a degraded position of dependence.

The BIA's failings have been compounded by an almost total lack of accountability. Through political apathy, neglect and gross irresponsibility, Congress and successive presidential administrations have allowed the BIA to function almost entirely without oversight. Our politicians have stood aside while the bureau and related federal agencies lavished billions of dollars on programs that have not worked, that may not reasonably be expected to work and that, in many cases, the Indians themselves did not want.

Congress seems unable or unwilling to tackle the problem, and the Indian tribes are reluctant to surrender their dependence on liberally dispensed federal dollars. To say the situation is a mess would be an understatement: It is a scandal.

The current relationship between Washington and the Indians is rooted in some 600 treaty obligations between the federal government and the Indian tribes, compacts guaranteeing that Washington would shoulder the burdens of Native Americans in exchange for their ancestral lands. This paternalistic relationship, however, has been a debilitating disaster for Indians.

The Republic's series indicates that a complete overhaul of the Indian program is past due. The long-suffering American taxpayer no longer can be asked to fund a bureaucracy that devours 90 cents of every dollar Congress allocates for Indians, money that never reaches the reservations or the people it is designed to help.

Congress should undertake a comprehensive review of the Indian program, with a view to reducing the size of the bloated bureaucracy, decentralizing the system, gradually turning management of Indian affairs over to the tribes, restoring a sense of dignity, responsibility and self-respect to Native Americans and stimulating more self-government and local control on the reservations. Washington, in short, needs to get out of the Great White Father business.

A8 THE ARIZONA REPUBLIC
MONDAY, OCTOBER 5, 1987

Fraud in Indian country
A billion-dollar betrayal

Indian's oil, identity stolen

Driller, lawyers for U.S. certify black impostor

By CHUCK COOK,
MIKE MASTERSON
and M.N. TRAHANT
The Arizona Republic

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TULSA, Okla. — Austin Walker was a homeless, jobless and destitute Creek-Cherokee Indian who should have been a millionaire.

But he was denied the money due him because government attorneys representing the Bureau of Indian Affairs failed — criminally, some claim — to represent him.

The government lawyers joined with an oil company to pass off a black man, also named Austin Walker, as a Creek-Cherokee Indian. They then allowed the man, identified as a "full-blood Negro," to sign an oil and gas lease on the Indian Walker's allotment land in Creek County, court records show.

And those same government attorneys stood by as more than $1 million worth of oil and gas was pumped from the Indian's allotment, then opposed Walker in court when he fought for the money that was due him.

Second in a series

Walker's problems paint a striking story that shows why Indians nationwide are losing confidence in government lawyers acting on their behalf. That trust is being eroded by what some claim is growing legal malpractice on the part of federal attorneys assigned to represent Indian interests.

Walker is by no means an isolated example, as discovered by *The Arizona Republic.*

His case — along with another filed by the heirs of Susie Chuwee Blackwood in Oklahoma and a third by a group of Indians against Sanguine Ltd., an Oklahoma oil company — are graphic examples of how some government attorneys and BIA officials seemingly work against the best interest of Indians, the very people they are sworn to represent.

In the Walker incident, government attorneys participated in a lease-fraud case that has left even veteran Oklahoma judges and oilmen shaking their heads.

In the Blackwood episode, which, like the Walker case, was handled by the Interior Department's regional solicitor in Tulsa, federal attorneys tried to force Indians to sign an oil and gas lease agreement that clearly was not in their best interest.

Walker's battle with the government to claim his money began in early 1983, when a small oil producer, Bristow Resources Inc., tried to lease his Indian allotment land in an oil-rich area southwest of Tulsa.

The Austin Walker who owns the land lives quietly in Black Gum, about 80 miles from the allotment area. BIA officials said they could not locate Walker, but Bristow Resources found a black man with the same name in Sapulpa.

With attorneys from the Interior Department's regional solicitor's office looking on, a state district judge on Feb. 10, 1983, certified the black man as a ⅛ Creek-Cherokee Indian.

The 66-year-old impostor said no one ever questioned his race when they were certifying him an Indian.

Once certified, the Bristow company paid him $4,000 to lease the land.

Using that bogus lease, the oil company drilled on the Walker land — and hit pay dirt, pumping $1.3 million worth of oil and gas.

Phil Elias, owner of the oil company, could not be reached for comment, but the firm's accountant, Ralph Osborne, said Bristow Resources would make no comment since the Walker case was still in litigation.

Bristow Resources is operated out of the same office as Phil's Used Cars in Bristow.

In September 1983, Walker, the Indian, went to the BIA office in Muskogee to collect about $80 he received annually for leasing his Creek County property to a livestock producer — the same rich, oil-producing land then being drained by Bristow Resources.

But there was no money in Walker's account. He found that Rex Herren of the Interior Department's regional solicitor's office had canceled the livestock grazing lease.

Walker called the office, and Herren, who had represented the BIA when the black man was falsely certified as an Indian, told him to come to Tulsa at once.

Walker, 46, had no money and no car, so he hitchhiked to Tulsa. There, he met with Herren and produced documents showing he was both Indian and the actual owner of the land, something the black man later said he was never asked to do.

The appearance of the Indian Austin Walker touched off major chaos and a flurry of frantic phone calls.

Herren called the state judge who had certified the black man

—[illegible]

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as an Indian. The judge telephoned attorneys for Bristow Resources. Those attorneys called Herren repeatedly.

During those phone calls, the Bristow firm's attorneys told Herren about three producing oil wells, court records show. The company was put in the position of having major oil wells on land to which it had no legal rights. Herren told Bristow's attorneys where to reach the Indian Walker.

Bristow sent Veta Germane, a company employee, to persuade Walker to sign a legal lease. When Germane found Walker, the Indian had just completed an auto-mechanics course at a trade school in Okmulgee. He had no home, no money and, according to court records, was living out of his cousin's car.

Germane gave Walker $500. Walker said in an interview with *The Arizona Republic* that it was clear that the money obligated him to accept a lease. He said he called Herren, who told him he could cash the check.

Germane then told Walker that Bristow Resources would pay him $4,000 for the oil and gas rights on his land, a sum that turned out to be a *fraction* of the land's worth. Walker also said he wasn't told that oil already had been pumped from his land by the company.

"I didn't know a thing about the oil and gas, and at that time, I was broke, so $4,000 sounded like all the money in the world to me," Walker told *The Republic.*

"So I said for sure that I'd sign it."

In addition to Germane, Bristow Resources hired as a consultant Harold Schultz, who recently had resigned as a government attorney in the Tulsa solicitor's office.

Court records show Schultz agreed to represent Walker at a state District Court hearing, which is necessary to validate Indian oil and gas leases in Oklahoma.

Herren testified in court he "relied on Schultz (who was working for the oil company) to represent Austin Walker rather than assume the duties himself" as solicitor.

This is unusual, because the solicitor's office is charged with representing Indians in such matters.

On Oct. 14, 1983, Herren met with state District Judge Streeter Speakman, who earlier had certified the black man as an Indian. At that time, court records show, Herren told the judge about the oil production on Walker's land.

Instead of being assisted by the solicitor's office at the lease hearing, Walker in [illegible] was represented not by Schultz but by another Bristow Resources attorney.

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U.S. District Court Judge H. Dale Cook wrote this year in a lawsuit brought by Walker against the United States that the government's allowing an oil-company lawyer to represent Walker in the lease hearing amounted to "a complete breakdown in the fundamental principles of legal representation."

"Bristow Resources and Austin Walker were in an adversarial position, in that Walker would expect to receive the highest price possible for a lease," Cook said.

He didn't.

On a lease worth at least hundreds of thousands of dollars, Walker received only $4,000, and the federal lawyers who were supposed to represent him approved the deal.

Court records show Herren actually urged Walker to sign the lease with Bristow Resources, telling him $4,000 was a "fair price."

During the lease hearing in state court, the federal judge later noted, Walker was the only person in the courtroom who still did not know there were producing oil wells on his land.

There were other irregularities.

Normally, Indian lease hearings in Oklahoma courts are held on the same day of each month so oil-company representatives can be present to bid competitively. But in Walker's case, the state judge set an "accelerated hearing date."

Cook, the federal judge, called the state court actions "fatally flawed."

And he rebuked the BIA attorneys who were supposed to represent Walker.

"There is no justification for the Department of Interior to permit this type of procedural masquerade, wherein the government's trial attorneys know firsthand that the private attorneys filing these petitions (for Walker) are bought and paid for by the Indian's adversary," Cook found.

"I think it was a royal screw-up, and I think if you track it down from Day 1, that all the controls that were in place failed."

— BIA Director Ross Swimmer

He blasted the federal attorneys for "negligence and a breach of their statutory duty to represent the best interests of their client-Indians within the ... tribes who are titleholders on restricted Indian land."

Walker said he took the $4,000 after the lease hearing in state court and "felt like a king."

He then went to Bristow's office and signed a document he thought was part of the settlement agreement. In essence, it was a legal document releasing about $300,000 in accumulated royalty fees.

But Walker's relatives who worked for the BIA in Muskogee told him soon after he accepted the $4,000 that something was wrong with the Bristow deal. Walker ended up retaining John D. "Rocky" Boydston, a Tulsa attorney. And that led to the federal suit before Judge Cook.

Boydston said he immediately realized the deal was a sham and Walker had been the victim of a million-dollar fraud.

At first, he tried to get Interior Department and BIA officials to help Walker recover his money. They refused.

In a July 10, 1985, letter to Justin P. Patterson, assistant solicitor for the Interior Department in Washington, Boydston wrote:

"You obviously don't know much about Indian law, legal ethics or oil and gas. I assume from your response that you also don't know about or care about the problems Indians have with oil companies and government bureaucracy."

Boydston further warned, "What you have just brushed aside is the making of a major scandal, for which you will bear a major responsibility in exposing to public light."

But the government wouldn't budge. Instead of helping Walker, it became his legal adversary.

Boydston requested a criminal investigation, but the U.S. attorney's office in Tulsa refused to act.

He then filed suit against the government on Walker's behalf in federal court at Tulsa.

In a July Interior Department inspector general's report, investigators noted that after Walker filed the lawsuit, "the Walker file was discovered to be missing" from the Tulsa regional solicitor's office.

The file was found two weeks later, but critical notes related to the case were missing and have never been found.

During the trial, government attorneys attacked Walker. They presented as witnesses three government appraisers who testified that the $4,000 price paid for the lease on the producing oil and gas land was a fair arrangement.

The federal judge, obviously angered by their version, called their testimony "incredible, unworthy of belief and not regarded by this court as reasonable."

Series at a glance

This series was reported by Chuck Cook, M.N. Trahant and Mike Masterson, who headed the project. John Doherty provided research assistance.

☑ Sunday: Federal agencies swallow billions each year, but life remains poor for the Indian.

☑ Today: The case of the two Austin Walkers and how the government cheated one.

☐ Tuesday: New reservation homes: Too costly, too few and unfit to live in.

☐ Wednesday: The worst health care that tax money can buy.

☐ Thursday: Why reservations are havens for criminals.

☐ Friday: Federal roadblocks to economic development on reservations.

☐ Saturday: Shifting U.S. policy toward Indians.

☐ Sunday: Indian education: Lessons in inadequacy. Also, Indians sound off on U.S. aid.

On March 19, Cook awarded Walker $685,368.

Walker still has not collected the money, and the government has filed a notice of appeal.

Herren refused to be interviewed when contacted by *The Republic*, saying only, "I think, obviously, an error was made."

He would not say who he felt made the error.

BIA Director Ross Swimmer admitted officials from his agency and the solicitor's office were "guilty of omission" in the Walker case.

"I'm not sure they've determined there's any activity where anybody got any money out of the deal," Swimmer said.

"I think it was a royal screw-up, and I think if you track it down from Day 1, that all the controls that were in place failed."

Soon after Cook's ruling, the head of the Tulsa solicitor's office retired, and Herren resigned.

Herren's actions in the case were recently investigated by the interior inspector general's office.

Investigators concluded Herren had acted improperly in the case but found no criminal intent. They added that he had violated regulations by failing to disclose the interest he held in oil and gas wells in Oklahoma. But they allowed him to amend his disclosure statement.

Roger Hilfiger, U.S. attorney for the Eastern District of Oklahoma, based in Muskogee, considered prosecuting Herren on charges of making false statements, criminal conflict of interest and perjury.

But, the investigators said, "Hilfiger does not feel there was any criminal intent in this case by Rex E. Herren."

Ironically, Hilfiger was representing Herren in the civil suit filed by Walker at the same time this decision not to prosecute was reached.

Additionally, the investigators reviewed Herren's actions in a case involving the heirs of Susie Chuwee Blackwood, also of Oklahoma.

As with the Walker case, they concluded he had acted improperly but without criminal intent.

In that case, Herren and the solicitor's office wanted Blackwood's heirs to sign a lease agreement for mineral rights on their land against the advice of BIA realty specialist Harold Wade of Tahlequah.

Wade told them the lease was not in their best interest because they apparently were owed money for previous lease royalties that had accumulated since 1969.

When Wade refused to go along with the lease, he was ordered by the solicitor's office and officials of the Muskogee BIA area office to get the lease signed. Wade refused and was disciplined for that refusal.

Herren then took an Indian BIA employee with him and went to the family and persuaded them to sign the lease.

Wade said he [illegible] to have the lease signed because records showed that an oil company had been producing oil and gas from the property since 1957. But, he said, there was no record of the Blackwood heirs' ever signing a lease or receiving royalty payments.

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In another case in Oklahoma, a U.S. District Court judge allowed a group of Indian landowners to intervene in a lawsuit against the BIA by Sanguine Ltd., an oil-production company that was attempting to force the federal agency to pool oil revenues of Indians and non-Indians.

State law in Oklahoma allows pooling of revenues under a procedure called "communitization."

A favorable decision would have allowed non-Indians to share Indian royalties, the Indians claim.

The Indians successfully argued the Anadarko area BIA director, at that time Stanley Speakes, had not represented their best interest in dealings with Sanguine. Speakes is now area director for the BIA in Portland, Ore.

A federal appeals court found, "Counsel for government defendants agreed the area (BIA) director's actions were unlawful."

The incidents in Oklahoma apparently are not isolated.

Indian leaders, BIA employees and even a former president agree the system is one ripe for corruption.

Then-President Nixon recognized the danger of federal lawyers' representing both Indians and the government as early as 1970.

Nixon said those legal battles often place the government "with an inherent conflict of interest."

'They're draining him dry'

Indian not given penny as drillers siphon oil

By CHUCK COOK,
MIKE MASTERSON
and M.N. TRAHANT
The Arizona Republic

PONCA CITY, Okla. — Press Primeaux's home sits on a wealth of oil and gas reserves.

From his front door, he watches large oil rigs with their praying-mantislike heads sucking oil day and night from thousands of feet beneath his 120 acres.

But the frustrated, full-blooded Ponca Indian has not received one cent from the oil and gas being drained from under his property.

While federal agencies have ensnarled Primeaux's land in a knot of bureaucratic red tape, oil companies have drilled 10 producing wells on adjacent non-Indian land and have pumped more than $2 million worth of oil and gas from them. Part of that came from under Primeaux's land.

In his case, and thousands of others around the country, federal agencies are allowing oil companies to take oil and gas from beneath Indian and federal land without paying royalties on it.

Many of these cases constitute outright theft or fraud, stemming from a practice called "drainage." It occurs when several plots of land sit atop a single pool of oil or gas and one or more property owners take a disproportionate share.

The Interior Department's Bureau of Land Management, which is supposed to monitor drainage nationwide, has grossly failed to correct the problem. An analysis of a recent federal audit, obtained by *The Arizona Republic* under the Freedom of Information Act, shows this misfeasance has deprived Indians and the federal government of possibly $5.7 billion in oil royalties.

The problem is so acute that the BLM has more than 8,400 drainage cases on Indian and federal lands it has not investigated and only 16 people nationwide assigned to the job. With that caseload and staffing, federal auditors calculated it would take the agency 53 years just to clear its current backlog.

Marlyn Jones, a BLM specialist in Denver who is studying the government's policy on the drainage problem, acknowledged, "It is difficult to pinpoint losses.

"From one perspective, things look pretty bleak. It's evident the problem needs more attention, and the bureau is giving it more attention."

Geologists have told Primeaux that his land sits atop a large pool of oil and gas. The Ponca, who is disabled from a hand and leg amputation and must undergo kidney dialysis as a result of chronic diabetes, is frustrated because federal officials hold his oil-rich land in [illegible].

The key points

1. The government has stood idly by as oil companies unlawfully siphoned an estimated $5.7 billion worth of oil and gas from beneath federal and Indian lands.

2. The problem is so large, and so ignored, that the Bureau of Land Management has a 53-year backlog of investigations.

3. Recent audits show the government could recover much of its losses by adding inspectors, but officials refuse to do so.

BIA officials contended in a recent letter to Primeaux that the land already is leased, although documents clearly show a lease on the land expired almost a year ago.

When he tried to get the BIA to take action, Primeaux claims, agency officials tried to extort $900 from him just for putting his land on a lease list. He refused and reported the incident to the Interior Department's office of inspector general, which is investigating those allegations.

Ray Springwater, a realty officer at the Pawnee agency who supposedly asked Primeaux for the money, denied any wrongdoing.

He acknowledged telling Primeaux that he may have to pay that much but said the money was not for a bribe but was to cover advertising and lease sale costs in case no firm wanted the oil rights.

"I told him if we didn't get bids, he would have to pay for that sale," Springwater, a full-blooded Cherokee, said.

Under federal law, the BIA and the Bureau of Land Management are supposed to ensure that Primeaux is paid for the oil that is siphoned from under his land.

"If they would pay us for our oil and gas, it would sure help us over the hump financially," Primeaux said.

"I've made several calls to the BLM complaining about drainage, but they refuse to make an on-site inspection. How can they say there's no such drainage if they don't come here and look?

"I don't think these people are qualified."

BLM officials argue that there's no drainage on Primeaux's land. However, Marvin Brubaugh, a veteran Ponca City oilman, disagrees.

"They're draining him dry," Brubaugh said.

Similar stories abound throughout the nation, auditors say. They found cases in which a company holding a lease on Indian or federal land also has oil and gas leases on adjacent property.

In many cases, the leaseholder drills on the adjoining land because royalties paid to Indians and the federal government usually are higher since leases on those lands are auctioned to the highest bidder.

Even if the BLM wanted to take immediate action to collect the billions that are literally being stolen from the government and Indians, auditors indicated that the agency is so disorganized and incompetent it probably could not.

The inspector general's audit found that none of the BLM's 15 area offices had an adequate program to deal with this costly drainage rip-off. The auditors also said that the BLM's record-keeping systems are in disarray.

Much of this chaos came about, auditors said, because BLM officials assigned to this program often are incompetent or unqualified.

Even when BLM field offices try to pursue the growing drainage problem, they get confusing guidance from the agency's leaders in Washington.

For example, agency field investigators recently dropped investigations of seven "fraudulent" drainage cases in New Mexico and Wyoming because they were "uncertain about how to pursue this type of case," the audit found.

Three of these cases were worth $1 million each to Indians and the government.

The program to prevent fraudulent drainage from oil and gas reserves located under federal and Indian lands is a relatively new one.

The BLM got the program in April 1983 during a reorganization of the Interior Department's minerals-management program.

Since then, the auditors reported, more than 60 percent of the BLM's drainage professionals have left the program. As a result, costly mistakes have occurred.

The audit noted that one inexperienced petroleum engineer "made errors on two economic analyses."

The end result was that he allowed an oil company to walk away with 236,000 barrels of oil, worth about $6 million.

BIA turns tribes' resources against them

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Uranium, coal cases reveal U.S. duplicity

By CHUCK COOK,
MIKE MASTERSON
and M.N. TRAHANT
The Arizona Republic

CROWNPOINT, N.M. — Officials in the Bureau of Indian Affairs and Interior Department abandoned their trust responsibility to Indians and may have acted unlawfully by siding with a Fortune 500 oil company in a dispute over $350 million worth of uranium.

Instead of representing the best interest of poor and undereducated Navajos who owned the mineral rights, the federal officials sided with Mobil Oil Co., which was attempting to lease uranium-rich land at less than market value.

The case led to an Indian lawsuit — Secretary of Interior Donald Hodel and BIA Director Ross Swimmer were named as defendants in an amended complaint — and is a graphic example of a growing and disturbing trend in which government officials turn against the Indians they are paid to represent.

The most flagrant breaches identified during a six-month investigation by *The Arizona Republic* occurred in cases involving multimillion-dollar contracts for natural resources, such as uranium and coal.

In the uranium-leases case, Senior U.S. District Judge E.L. Mechem in Albuquerque, N.M., found, "The BIA and Interior generally seem to have been more concerned throughout the leasing process with their relationship with Mobil than their relationship with the Indian owners."

In a sharply worded Aug. 14 decision voiding the leases, Mechem said federal officials had "severed at the knees" the interest of the Indians when they "concocted a dubious legal theory" and "approved the leases over the heads of those landowners who were in the process of negotiating better terms."

"The record disclosed many lesser instances of the BIA's unwillingness to assist the Indian owners," Mechem added.

He said federal officials refused to allow the Indians time to negotiate, failed to respond to their requests for technical assistance and refused to turn over financial records regarding the leases.

Mechem concluded, "The secretary (of Interior) therefore approved the leases in breach of his trust responsibilities to the Indian owners."

The dispute arose out of 1972 leases that Mobil held on 64 Navajo allotments near Crownpoint that were uranium-producing land. By 1977, Mobil estimated the Indian lands could yield at least 10 million pounds of uranium ore worth $350 million. But the company feared it could not reach commercial production by 1982, when the 10-year leases expired.

Mobil then began a series of meetings with BIA and Interior Department officials that resulted in 10 unwarranted extensions of the leases, court documents show.

The judge said some of the "poor and undereducated" Navajos agreed to leases after Mobil officials made "false threats concerning non-existent deadlines," but the McLanahan family would not.

Family members Rosalind McLanahan of Window Rock, Delores Homer of Mesa, Loretta McLanahan Brutz of Ganado, Herman McLanahan of Window Rock and and Larry McLanahan of Cottonwood, Calif., refused to bow to oil-company and BIA pressure.

But officials of the Interior Department solicitor's office "concocted" a legal theory that two-thirds of the landowners were all that were needed to approve the leases. The McLanahans controlled just less than one-third of the leases, so the bogus ruling in effect gave others the right to control their leases.

"The secretary (of Interior) and his delegates at Interior and the BIA never so much as made a counteroffer to Mobil," Mechem said. "The secretary not only accepted with minor changes the terms Mobil offered for a new two-year extension of the lease, he approved a new 10-year lease form on the same terms."

The McLanahans sued in 1983, and Mechem on Aug. 14 struck down the uranium leases.

"This was a spiritual kind of fight for us," Brutz said.

"It was the David vs. Goliath concept.

"In the end, we had to fight this big, big company, the Interior Department and the BIA.

"We didn't get any help from the BIA. They abandoned us."

Interior Department officials refused to comment on the case, referring all questions to the BIA.

Swimmer, the BIA director, said he was not familiar with the case.

Mobil spokesman John Lord in New York said the company was "disappointed by the U.S. District Court decision." He said that during the 60-day appeals period, company officials are studying what action to take.

The uranium-lease case is an example of how federal officials mismanage natural resources that belong to Indians. It is not an isolated case.

Indians nationwide also own rights to billions of dollars worth of coal, which, if properly marketed, could pull many tribes out of poverty and off the federal dole.

But most Indians have been unable to claim that wealth because tribal administrations and the Interior Department have mishandled Indian coal leases.

"On the Navajo Reservation, some of the leases that have been made up there have been set aside. The same with some of the tribes in other states," said Sen. Dennis DeConcini, D-Ariz.

"The tribes sued the BIA and won.

"The courts ruled that the trustees, the BIA and the Interior Department, did not act in the best interest of the beneficiaries, the Native Americans.

"When you talk about resource management, they (the BIA) just don't have it.

"I would rather have a tribal council dealing with Exxon or Peabody Coal than some guy back in Washington, D.C."

The government's ineffectiveness in handling coal leasing was shown in a General Accounting Office report released in September by Rep. Mike Synar, D-Okla.

The report showed that failure by the Interior Department to carry out provisions of a 1976 federal coal-leasing law cost the government about $187 million in lost revenues from 1976 to 1984.

The GAO said the loss was caused by the Bureau of Land Management's failure to increase royalties and rent paid by holders of 149 coal leases as required under the Federal Coal Leasing Amendments Act of 1976.

The office said, however, that the problem appeared to have been corrected in 1985.

The key points

1. Federal agencies have done an abysmal job developing and protecting natural resources owned by Indians.

2. In a recently decided case in New Mexico, a federal judge ruled that the secretary of the interior and the director of the Bureau of Indians Affairs violated their trust responsibilities by siding with Mobil Oil against Indians in a $350 million uranium deal.

3. Indians own rights to billions of dollars worth of coal, which could pull many tribes out of poverty and possibly off the federal dole, but tribal administrations and the Interior Department have mishandled Indian coal leases.

4. In some instances, the BIA has approved contracts in which companies took coal from Indian lands and paid only pennies per

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The GAO report was requested by Synar, who is the chairman of the House environment, energy and natural-resources subcommittee. It covered Colorado, Wyoming, Utah, New Mexico and Oklahoma.

The Oklahoma Democrat said the department "simply failed" to make the required readjustments in lease terms.

The Interior Department, as trustee for Indian lands, must ratify all agreements on development of Indian natural resources.

As with other tribal natural resources, the federal government has allowed major companies to take coal from Indian lands at a fraction of its worth and has stalled development of key coal reserves.

Among the tribes most dramatically affected by this government mishandling of coal reserves are the Navajos and Hopis in Arizona and New Mexico and the Crow Tribe in Montana.

The Navajo Tribe owns rights to hundreds of millions, if not billions, of dollars worth of high-grade coal.

A bitter land dispute involving the Hopis and Navajos has sparked a three-way feud among the two tribes and the federal government over some of the richest coal deposits in the West.

Pawns in this high-stakes, natural-resources game are the approximately 8,000 Navajos who are to be relocated. They are being moved from Big Mountain reservation land claimed by the Hopis, at American taxpayer expense. Few Hopis lived on that land, but they are now claiming rights to it.

The areas where the government is planning to allow strip mining include the San Juan Basin near Dinetah, the ancestral Navajo homeland, and at the Chacoan Anasazi archaeological remains in northwestern New Mexico. They also include traditional Navajo grazing lands where sheep and goat herders eke out a living just a few feet above rich coal seams.

Until recently, coal contracts on the Navajo Reservation in Arizona and New Mexico were so bad that the amount the tribe was paid for a ton of coal was less than the price of a can of soda pop.

For example, in 1966, Peabody Coal Co. signed a lucrative coal lease for Black Mesa with the Navajo and Hopi tribes.

The company got the rights to the coal by paying $100,000 to the Navajos and only $10 to the Hopis.

The peak royalty rate for both tribes, approved by the BIA and Interior Department, was 35 cents per ton at a time when the going rate was $1.80 per ton.

In southern Montana, the government's failure to develop coal reserves have hurt the Crows.

Crow Reservation tribal officials know they are sitting on billions of dollars worth of coal. But they don't know how much they have. They have asked the BIA for figures, but agency officials have refused to supply them.

Many financially strapped tribes, such as the Crows, could become almost self-sufficient if their natural resources were properly managed by the BIA, Indian and government leaders say.

Their assertions are backed by statistics. For example, Indian tribes own and control an estimated 15 percent of the nation's coal resources, including one-third of the low-sulphur coal that can be strip-mined in the West.

Production figures from 1984, the last year they are available, show that 20.5 million tons of coal were produced from five mines on Crow lands in Montana and on Navajo and Hopi lands in Arizona and New Mexico. But government obstructions have prevented further development.

Under federal law, Indian tribes, unlike states, cannot assume regulatory authority over coal-mining operations within their boundaries without federal permission. The Surface Mining Control and Reclamation Act of 1977 requires Indian tribes to await congressional enactment of specific legislation before they can assume the same control.

The move to give the Indians control over their own natural resources has been hampered by a dispute within the Interior Department over the definition of exactly what is and is not "Indian land."

It also has been stifled by multiple regulatory authorities and the inability of tribes to regulate coal mining in which they have a vested interest.

While that dispute rages, mining companies continue to operate in some areas under outdated contracts that afford little economic gain to Indians.

TULSA TRIBUNE
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Indians: counting their losses

A
Vanishing
trust
Tribune special report

Series at a glance

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☐	WEDNESDAY:	Battles in Court
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☐	NOV. 18:	Rose Swimmer -- The future BIA

Stories by EDWARD M. EVELD,
GRANT WILLIAMS and MARY HARGROVE
Tribune writers

BEFORE Oklahoma became a state in 1907, tribal lands were split among the Indians while the federal government promised to stand guard over its new wards.

Within a few years, there was "an orgy of plunder and exploitation probably unparalleled in American history," wrote author Angie Debo.

Strikingly similar stories have been repeated in the 1980s, detailed in numerous lawsuits, congressional hearings and interviews with dozens of Indians.

The Tulsa Tribune has spent four months investigating the role of the U.S. Department of the Interior as trustee over Indian and federal oil and gas leases which have yielded billions of dollars in revenue.

Debo exposed the earlier scandal in her book "And Still The Waters Run" in 1940.

In scathing detail, she documented cases where Indians were conned into selling mineral leases for fractions of their worth, guardians withheld funds from Indians desperate for food and shelter, lawyers gouged naive Indian clients for court costs and the government refused to explain where the money from oil and gas royalties disappeared.

Oklahoma's present-day problems have been the focus of special congressional studies. The state has 51 percent of all Indian leases in the United States.

In the past five years, individual Indians or tribes in Oklahoma have received $146 million in royalties from oil and gas wells.

Shadowing the gains during those years has been a litany of abuses and mismanagement:

*Five television sets and two stereos were purchased in a two-year period by an Indian described by auditors as an alcoholic.

His Bureau of Indian Affairs account, from which he drew $3,274 for those purchases, was under supervision at the Anadarko agency to prevent frivolous use of funds, according to a 1985 auditors' report.

*At the Concho BIA agency near El Reno, auditors reviewed 863 "whereabouts unknown" accounts in March 1984 totaling $407,075.

Little had been done to locate the Indian account holders although auditors concluded, "We do not think it would be overly difficult to locate many of these individuals."

They proved their point by tracking 10 Indians owed more than [illegible] in a minimal length of time."

The bureau acknowledged it did little to find account holders in the past.

Joe Walker, acting area director of the Anadarko BIA office, said, "The agency might have spent 25 hours trying to find one person" and not been successful.

*Thomas Wahnee, a Comanche from Fletcher, wanted to check his oil and gas lease payments in 1984.

He was refused access to his own records unless he paid a search fee which he was told "will probably exceed $1,000" to the Minerals Management Service, the government agency entrusted by law with keeping those records for him. The fee was reduced to $500 when his lawyer appealed.

Following pressure by U.S. Rep. Mike Synar, D-2nd District, an audit was conducted and completed in May 1986 identifying $41,000 in underpayments and $15,000 in late payments by the oil company to Wahnee and his uncle. That money was sent to the BIA to distribute in January of this year, but Wahnee still has not been paid.

More than three years after his inquiry, the money is being withheld while the oil company appeals the audit results.

The uncle, who shared in the lease with him, died last summer.

"I'm 74 years old. I'll probably die before it gets here," said Wahnee, a retired roofer.

These are not isolated examples.

The U.S. government promised Indians in treaties that they would assume a trust responsibility in exchange for the land.

Tribal leaders were assured their people would be protected "as long as the grass grew, waters run and the sun rises . . ."

This is the first in an eight-part series on Indians and their vanishing trust.

TULSA TRIBUNE
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Protection fails while oil gushes

AUSTIN Walker's oil poured out of the rolling hills of eastern Oklahoma, but he was the last to know.

An oil company had tapped a robust pool on Walker's land without his knowledge. A state judge and a federal attorney were aware of the production, but they didn't tell either.

At a court hearing eight months after the first well was drilled, the government stood by as the company bought a lease from the Creek-Cherokee Indian for a fraction of its real value.

That transaction began a four-year odyssey through a governmental system that continually failed Walker, an Indian guaranteed protection under federal law.

ATTORNEY John Boydston lost his temper.

He glared at the letter from the U.S. Department of the Interior dismissing his complaints about the agency's handling of the Austin Walker lease.

"Consider this," Boydston wrote back, "if Mr. Walker had been fully and properly protected, would Mr. Walker have accepted $4,000 for a lease which is undisputedly worth more than $1 million? Would you?"

In the letter, the government stood by its attorney, Rex Herren.

"You obviously don't know much about Indian law, legal ethics or oil and gas," Boydston told a Washington appeals lawyer.

"I assume from your response that you also either don't know about or care about the problems Indians have with oil companies and government bureaucracy.

"What you have just cavalierly brushed aside is the making of a major scandal . . ."

Boydston, who just had resigned after serving as Oklahoma Court of Appeals judge for four years, didn't wait for a response.

That was in 1985. Boydston rolled up his sleeves for the battle ahead.

IT WAS September 1983 that Austin Walker first realized the federal government had failed to protect his mineral rights.

He stumbled across the truth as he searched for a place to sleep. Graduation from Oklahoma State Technical School in Okmulgee meant no more nights in a dormitory.

Homeless and unemployed, the then 43-year-old man was desperate for money.

He hitchhiked to the Bureau of Indian Affairs office in Muskogee to see if the agency had received any payments on his behalf for a minor pasture lease.

Mary Downing, a BIA clerk,

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Photo by Tom Loebrke, the Arizona Republic

Austin Walker, who lives near Lake Tenkilller, will receive more than $600,000 in damages from the government.

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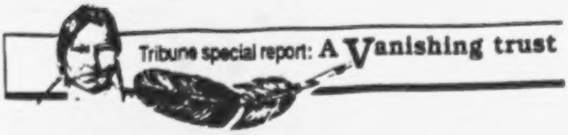
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Indians

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thought he was joking. After all, she had seen documents showing Walker received a large bonus earlier in the year for leasing his land to an oil company.

It was the first Walker had heard of the deal. Downing phoned Herren, who was second-in-command at the Interior Department's regional solicitor's office in Tulsa.

The call gave Herren a jolt. Eight months earlier in Creek County District Court, without so much as asking to see a driver's license, Herren and Judge Streeter Speakman had approved a lease between Bristow Resources Inc. and another man named Austin Walker.

But the Austin Walker in court that day in February 1983 was not the fullblood Indian who owned the 40-acre tract in Creek County.

In fact, the Austin Walker in court that day was a black man.

THE BLACK Walker had only to confirm a series of statements from the oil company attorney setting out proof that he was heir to the Indian property.

"I just said 'yes,' whatever it is," Walker said, admitting later that he testified to being the grandson, son and brother of people he never had met.

The black Walker said later that oil companies and others hounded him for years to sell or lease the property. He said he decided to end the constant queries by agreeing to the Bristow Resources lease.

"They kept calling so I wanted to find out what's going on myself," said the 64-year-old Walker.

AFTER Downing alerted him, Herren told the Indian Walker to come to his office in Tulsa. Walker hitchhiked, carrying his Indian blood card with him for proof of identity.

Herren got on the phone.

He called Judge Speakman and then notified the oil company's law firm, McMillan, Vassar and Kelly of Bristow.

Calls shuttled back and forth among Herren, Speakman and the oil company attorneys which included Albert Kelly Jr., then a 30-year-old attorney and partner in the Bristow law firm.

The topic: Bristow Resources already had pumped a substantial amount of oil and gas from the property.

A new hearing would have to be held to approve a lease with the real owner. Herren told the law firm how to locate the Indian Walker.

SEVERAL DAYS later, on Sept. 19, 1983, Veta Germain, a landman hired by Bristow Resources, found Walker in Okmulgee and gave him $500 to sign an agreement to lease his land to the oil company.

Three days after that meeting, Germain and another oil company attorney, Harold Shultz, drove to Gore to talk with Walker, who was staying with a cousin. They would have to win approval of the lease from the judge in Creek County District Court.

The court hearing is one of the few protections Indians like Walker have against energy companies that may try to take advantage of Indians, who sometimes are unsophisticated in business matters.

These legal protections, which require competitive bidding to promote better lease terms, were well known to Shultz. Until his retirement five months earlier, he had spent 26 years as an Interior Department attorney.

His job had been representing Indians in identical state court proceedings to safeguard their mineral rights.

NEVERTHELESS, he and Germain traveled to Gore to ask Walker to relinquish federal protections on his land, doing away with the requirements for a court hearing and competitive bidding.

Walker refused.

On Sept. 17, 1983, Shultz called Herren to ask him about the possibility of removing the federal protections on Walker's land or, at the least, of waiving competitive bidding at the court hearing.

Herren told federal investigators he refused to consider either suggestion.

A new hearing was set for Oct. 20, 1983.

Even the date eventually would become an issue. At the time, Creek County District Court normally held Indian lease hearings each month on the first Thursday after the second Tuesday.

But the Walker hearing was set a week later. "This fact alone tended to suppress ordinary, legitimate bidding," Boydston asserted in a federal tort claim, pointing out that no other bidders were present Oct. 20.

SPEAKMAN, THE judge at the hearing, said later the date was moved from Oct. 13 to Oct. 20 because he had a schedule conflict and was out of town. He couldn't remember why.

Herren told investigators with the Interior Department's Office of the Inspector General that the date was changed because the judge was to to be in China with a delegation from the Oklahoma Bar Association.

Speakman said no special date was set exclusively to hear the Austin Walker case.

According to Creek County court records, two other hearings were set for that day. One was dismissed on the request of the petitioner; the other was continued to Nov. 10.

A review of Creek County Indian lease hearings under Speakman over five years showed that, except for holidays, the regular hearings dates rarely were changed.

THE UNUSUAL date was one reason no other bidders showed up, Boydston contends.

But he believes they also were kept away by a $1.4 million lien on the property filed two weeks earlier by Bristow Resources.

Boydston claims Bristow had spent about $350,000 to sink four oil wells but that the attorneys inflated the lien by more than $1 million to discourage others from bidding.

"The purpose was to cloud the title so bad no legitimate bidder would jump in," Boydston said.

This time, with the right Austin Walker in attendance, government officials made an even graver error.

Speakman and Herren approved an oil and gas lease with a $4,000 bonus for Walker — a deal identical to the one made with the other Austin Walker.

BUT THERE was a difference. By now, Bristow had hit oil on the property and, in fact, had been drilling for months. The value of the lease should have skyrocketed.

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"Every person in the courtroom on Oct. 20, 1983, except Austin Walker, knew there was substantial oil production on (Walker's) land," said U.S. District Judge H. Dale Cook in an opinion issued in March.

Judge Speakman was not unfamiliar with prices for oil and gas leases. Court records show that he held an interest in several wells.

At the hearing, when Herren insisted on competitive bids over the objection of oil company attorneys, Speakman launched into a discourse.

"What we've got here, as you well know, is that another man claiming to be Austin Walker, and with good credentials, came in here and leased this, and they had a competitive bidding.

"He leased his interest for $4,000 in a proper hearing where neither Bristow Resources nor the government nor the court had any idea that he was anything other than the real Austin Walker."

SPEAKMAN told Walker he could ask for bids or take the $4,000 "which they feel is fair and proper and which heretofore was fair and proper for the other Austin Walker."

The Indian Walker, an admitted alcoholic, said in a later affidavit, "Even the judge got very impatient with me when I did not answer just right about what I wanted to do. I was very confused and just wanted to get it all over with and go back to Gore."

Far from the $4,000 OK'd by Herren and approved by the court as a bonus for signing the lease, an expert appraiser later pegged the right price at $689,368.

THE DAY HAD just started for Walker. He was anxious to cash the check, and Bristow Resources employees assured him that their boss, Phil Elias, would oblige. They drove him to the company's office in Bristow.

Elias is owner of Phil's Used Cars in Bristow and president of the oil company which was formed in December 1980.

Elias provided the $4,000 in cash, then asked Walker to sign a document. Grateful for the money, Walker put his signature where he was told.

Unknowingly, Walker said, he had signed a waiver, giving up his claim to more than $363,693. That money represented proceeds from the sale of oil and gas taken from Walker's land between January and September 1983.

According to Judge Cook's opinion, "Without informing plaintiff of its meaning or consequence, Elias requested that plaintiff sign a bill of sale. Rex Herren was not present during this time."

Because Bristow Resources had no lease with the real Walker during that time span, the Indian had a claim to all of the money, Boydston later would argue.

Elias, through his attorney, Paul McBride, declined to comment about the case.

IT WAS only by coincidence that Walker questioned the terms of his oil and gas lease and sought help from a private attorney.

Elias had been so pleased to get the second lease at a bargain price that he gave rifles to three of his attorneys to show his appreciation, according to depositions.

But BIA employees said they overheard Shultz bragging about the gift from Elias.

Curious, they checked the BIA's records and guessed there was oil and gas production Walker hadn't known about. They urged him to get a lawyer.

Walker sought out Sandy Smith, a former Interior Department attorney now practicing in Muskogee.

After hearing the story, Smith saw a challenging lawsuit in the making. He drove Walker to Tulsa to talk to Boydston.

The Tulsa attorney said he was not surprised that Walker was persuaded by the oil company attorneys to accept the deal.

"When you're flat broke, $4,000 is a fortune," Boydston said of the bonus money Walker received at the lease hearing.

Boydston believed Walker had been cheated out of a real fortune.

HE TOOK THE case first to the Interior Department, but his federal tort claim was rebuffed. "We can find no evidence of a breach of duty or negligence on Mr. Herren's part," the department's Washington, D.C., attorney stated.

"Our investigation revealed that Mr. Herren fully apprised your client of his options in leasing his property and did, in fact, inform him that there were producing wells on the land."

The Walker file disappeared from the regional solicitor's office after Boydston filed the federal tort claim. The file turned up two weeks later, Herren told investigators, but personal notes he had taken about the Walker case were missing.

Boydston took the case to federal court.

At each step, he thought the federal government would find Herren's action indefensible and try to settle the dispute, saving taxpayer money.

"I was just amazed," said Boydston. "I'll tell you what I envisioned would happen. They would see it was such an ironclad case against the government that they would say, 'Let's go after the oil company and those attorneys.'

"They should have joined hands with Austin."

But the government fought on against the Indian — and lost.

IN U.S. District Court in Muskogee, Judge Cook sided with Boydston, his decision last March echoing the same angry disbelief.

Herren was "grossly negligent" in advising Walker at the court hearing in October 1983, Cook concluded.

Tulsa attorney John Boydston

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"The trial attorney has the duty to fully advise his client and openly advise the court of all matters within his knowledge, or get out of the courtroom . . ."

Cook awarded Walker $685,368 in damages from the United States.

Walker hasn't seen that money, but he should soon. The government decided last month not to appeal the case, and Boydston and the government's attorneys have negotiated a schedule of payments spread over 20 years.

U.S. ATTORNEY Roger Hilfiger in Muskogee said that because of U.S. Justice Department policy, he did not have the option to admit liability on the part of the government and settle the case out of court.

He said the government did consider appealing the case, but only to contest the amount of the award, not the issue of negligence.

In the past four years, Walker has received about $240,000 in royalties, Boydston said. The wells have produced very little in the past two years, he said.

On April 15, Elias, the Bristow oilman, received a federal grand jury subpoena in Tulsa, according to the Interior Department's independent Office of Inspector General.

Two days later — a month after Cook's decision — Herren resigned as assistant regional solicitor for the Interior Department covering a five-state area.

Herren told federal investigators the Walker case was "the biggest nightmare of my life."

HE HAD worked as an Interior Department attorney in Anadarko from 1974 to 1981. He left government work for a year and a half before returning in 1982, this time to the Tulsa solicitor's office.

While away, Herren worked for an Oklahoma City law firm that specialized in oil and gas title examination. He conducted seminars on the topic at the University of Oklahoma and Oklahoma City University.

However, Herren failed to disclose interests in oil and gas leases in Alfalfa and Seminole counties before returning to work for the department, according to a report by the OIG.

He filed an amended form four years later, after he was questioned by the OIG about the holdings. Herren said he had forgotten to disclose that information.

Herren left Tulsa and is living in Cordell in western Oklahoma.

HERREN DENIED any wrongdoing to OIG investigators and said he resented the implication he was involved in fraud. Walker insisted on getting his $4,000 in bonus money that day, Herren said, and he allowed the pressure from Walker to cloud his better judgment.

"I suggested to him a continuance in the proceedings until some other time, until we had time to get that (appraisal)," Herren said in a court deposition.

"And he became very upset. He was very upset at the prospect of the case being continued. And he was worried about not getting the $4,000 that day," Herren said.

"And I can't tell you his exact words, but in so many words he essentially said he didn't want me to interfere with the proceedings."

Investigators concluded Herren did not receive any compensation from Bristow Resources in the Walker case and that Herren's action did not have the intent "to criminally defraud Walker."

INTERIOR Solicitor Ralph Tarr said Herren insisted he told Walker, in the judge's chambers, about the production.

"We defended the case because there was a dispute (about whether Herren told Walker)," Tarr said. "Obviously, the judge pointed out a number of areas where our own procedures were not followed.

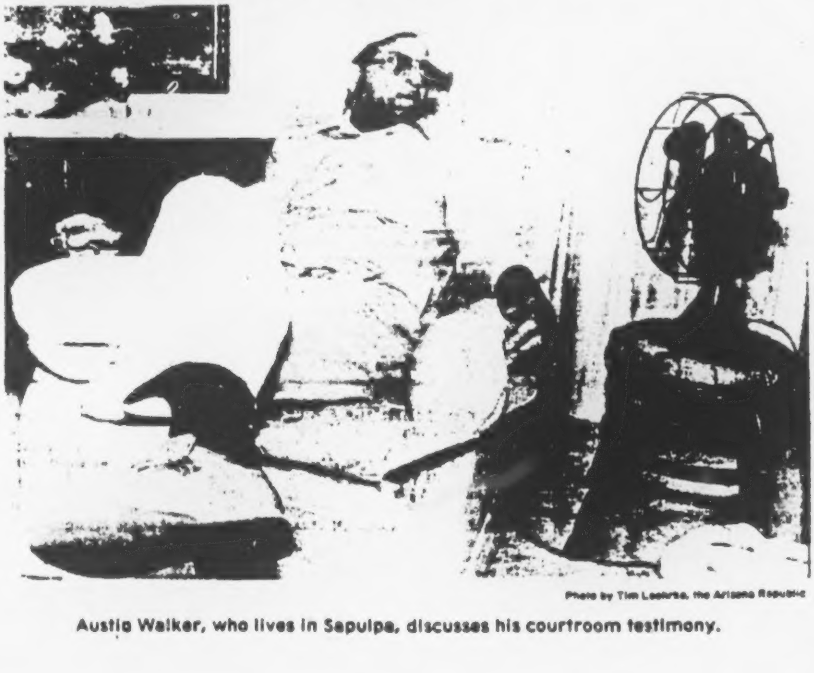

Photo by Tim [illegible], the Arizona Republic

Austin Walker, who lives in Sapulpa, discusses his courtroom testimony.

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Streeter Speakman
former Creek County
associate district judge

"Oftentimes people don't show up at these things to bid but that doesn't take us off the hook for not having an appraisal."

Herren told The Tribune last week. "In hindsight we've got perfect vision, don't we?"

IN THE MEANTIME, Boydston plans to move an $11 million lawsuit he filed against Bristow Resources and its attorneys from state to federal court, where he thinks it has a better chance of receiving an impartial hearing.

Boydston alleges the oil company and its attorneys conspired to cheat the unsophisticated Walker out of his property.

The suit has been on hold since it was filed in Creek County in December 1984.

It charges that Harold Shultz and Albert Kelly Jr., as attorneys paid by Bristow but representing both the oil company and Austin Walker, "actively concealed the true value of the lease" from Walker.

Walker never was told that because Bristow had trespassed on his land, he was entitled to all of the proceeds from the sale of oil and gas on his land, plus the wells and equipment placed there without his permission, the suit says.

The suit asks for $1 million in compensation plus $10 million in punitive damages.

Shultz has left Oklahoma and could not be reached for comment. Kelly declined to comment, deferring to his attorney, John Mantooth, who did not return phone calls.

THERE remain several nagging issues about the case, not the least of which is how the other Austin Walker moved through the court process undetected.

The OIG report concluded that the misidentification of the first Austin Walker was an honest mistake, although the judge and attorneys did not ask to see his Indian blood card.

Speakman, the Creek County associate district judge, said there was no reason to doubt the man who testified under oath was the Indian heir.

"As far as I was concerned, we conducted that thing in apple pie order," said Speakman, who retired in January.

Despite Cook's judgment, Speakman believes the Indian Austin Walker got a fair deal in October 1983.

Because of the production, there were royalties of about $80,000 waiting for him, Speakman said. "I thought, how lucky could this guy be?"

Walker, with a high school and vo-tech education, knew what he was doing, Speakman said. "You can go too far with this 'poor, old Indian' talk."

IT IS DIFFICULT to compare how other Indians were treated at Creek County lease hearings. The law requires transcripts to be made of the proceedings, but in more than 75 percent of the cases from 1982 through 1986, no transcripts had been filed.

Joy Naifeh, who was Speakman's court reporter for these cases, said she is to blame for the missing transcripts.

"It's all on record. I have the notes at home. I just haven't gotten everything filed yet."

Since January, when April Sellers White took over for the retiring Speakman, a new court reporter has been hired and transcripts have been filed with current cases.

HERREN has been criticized for many aspects of the case, but none more strongly than his failure to obtain an up-to-date appraisal on the land.

Interior Department procedures required that the government attorney appear at lease hearings armed with a recent mineral appraisal on the property.

The oil company's offer should meet the appraisal price before the government attorney will recommend approval of the lease. Herren did not have an appraisal.

He said later that he called an oil and gas consultant, but the consultant could not complete an appraisal in time for the hearing.

An appraisal prepared for the first hearing in February 1983 recommended at least a $2,000 bonus, but that was before oil began to flow.

JUDGE COOK said Herren's duty was obvious: to ask that the hearing be postponed until a new appraisal was made.

"The failure to move for continuance under these circumstances is negligence," Cook wrote.

Sharon Blackwell, an attorney in the Solicitor's Office in Tulsa, was trained by Herren to handle restricted Indian land cases. Obtaining an appraisal is routine and essential, she said in a court deposition.

Without an appraisal, "I would not be able to advise the Indian client. I am not a petroleum engineer," she said.

AS A RESULT of the Austin Walker debacle, some minor changes have been made in Indian land hearings.

Indians now are required to provide several pieces of identification, which are entered as evidence in court.

The Interior Department attorney now asks the Indians pointed questions to make sure they understand, among other things, the comparison between the appraisal price and the oil company offer and the fact that they are under no obligation to lease their land at all, even if they already have signed the papers with an energy company.

Tarr said based on several cases, including the Walker situation, he is having all procedures, particularly involving Indian trust land, reviewed in the Tulsa office.

A LARGER issue has yet to be resolved.

At lease hearings, it is the oil company's attorneys who draw up the court petitions on behalf of Indians, asking the court to approve the lease of Indian land.

In effect, the attorneys appear to represent both sides — the oil company trying to buy the lease as cheaply as possible and the Indian trying to lease his land at the highest price.

In his March judgment, Cook called the system a "procedural masquerade."

"This represents a complete breakdown in the fundamental principles of legal representation," Cook wrote. The private attorneys filing these petitions on behalf of Indians are "bought and paid for by the Indian's adversary."

Boydston and other attorneys also see the proceeding as a built-in conflict of interest for the oil company attorneys.

Ideally, the state court judge, the Interior Department attorney and the private attorney are charged with ensuring the Indian gets the best deal possible.

"In this case, all three of them let him down," Boydston said.

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JUDGE Cook flagged the problem in his court decision.

"Austin Walker was unrepresented at the proceeding," he wrote. "It is the Department of the Interior's responsibility to change this procedure."

Judge White said private attorneys are making a better effort to explain in court that they are being paid by the oil company.

And government attorneys are making it clear that they are present on behalf of the secretary of the interior to assist the Indian holders of restricted land.

Solicitor Tarr said the government, too often, comes in on the end of the process, something that is unavoidable.

"The landowner somehow links up with the oil company. They've got their deal made by the time we know about it," Tarr said. "You start standing between people and their money and it is a little bit hard to establish a relationship at that point, but we need to do it."

Austin Walker's name has become a byword for critics in the growing debate about how well the federal government fulfills its duty to protect native Americans and their property.

The best remedy, said Boydston, is to staff federal Indian agencies with employees who truly care about native Americans, "people who are sympathetic to Indians and take their jobs seriously.

"I haven't given up hope."

Stewardship under fire

A
Vanishing
trust
Tribune special report

U.S. probe to track mineral money flow

By MARY HARGROVE,
EDWARD M. EVELD and GRANT WILLIAMS
Tribune writers

ALTHOUGH it has spent most of this century as steward over federal and Indian lands, the U.S. Department of the Interior has not created a system that adequately accounts for billions of dollars in minerals payments.

The failure to manage minerals closely has jeopardized services for taxpayers in Western states faced with dwindling budgets.

But the impact is most severe on Indians who have watched their hopes for economic stability diminish year after year in paperwork and promises.

Many who receive royalty payments are elderly and depend on the income to buy food or pay for utilities.

Some 53 million acres of land are held in trust for Indians and tribes who must rely on the federal government to approve leases and to collect and account for royalties from oil, gas, uranium and coal contracts.

TWO weeks ago, the Senate Select Committee on Indian Affairs voted to seek $240,000 for the first three months of a special investigation.

The 13-member staff will examine the handling of Indian matters by the Interior Department. Tracking the mineral money flow will be its first task.

The probers will be building on an already stout base of materials.

Interior Department officials have clashed with congressmen for two intense years in a dozen hearings, argued with more than 50 critical audits by federal investigators and defended themselves unsuccessfully in lawsuits charging breach of trust responsibility.

The accounting never has been more important as the worldwide slump in petroleum prices squeezes the payments downward.

Last year, the department took in $3.7 billion in federal and Indian mineral revenues. This represents a 43 percent drop in revenues compared with the 1985 collections of $6.5 billion.

The monies make it the second largest revenue

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Indians

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generator in the federal government, behind the Internal Revenue Service.

OKLAHOMA has more than half of all Indian leases in the country. In the past five years, the oil and gas revenues have brought in $146 million to individuals and tribes in the state. This does not include $173 million collected by the Osages, who have their own system.

Indians with trust lands receive 100 percent of the funds collected by the Interior Department from those leases. Revenue in 1986 for individual Indians and tribes nationwide was $113 million.

States with federal lands within their borders split royalty revenues 50-50 with the federal government, with the exception of Alaska which receives a 90-percent share. Those leases bolstered state budgets last year by $424 million.

By the most conservative of estimates, underpayments are staggering.

John Simonette, an official with the General Accounting Office which monitors federal programs, told a congressional hearing in April that uncollected royalties "probably run in the several hundred million dollar range."

SHARING the burden and the blame for mineral leasing problems are three Interior Department agencies: the Minerals Management Service, the Bureau of Indian Affairs and the Office of the Solicitor.

The MMS collects the money for Indians and states with federal lands. The BIA works on lease arrangements, disburses money to Indians and supervises special Indian accounts. The solicitor provides legal advice.

The only Indian in Congress, U.S. Rep. Ben Nighthorse Campbell, D—Colo., sits on the House Interior Committee.

"We are all strung out and running so damn fast to keep up. Many things are done with hindsight and Band-Aid approaches," he said.

"I just don't know how it got so out of control, but it has created some fierce problems."

The dilemma stems from more than 80 years of mixing oil and honor.

THROUGH a series of treaties in the 1800s, the federal government accepted a responsibility to watch over the Indians as their lands were placed in trust.

That took on new meaning in Oklahoma when in the early 1900s the discovery of vast oil pools beneath Indian lands attracted scores of shysters who snatched the funds from Indians through graft, marriage and even murder.

Tribune photo

U.S. Rep. Mike Synar of Oklahoma, D-2nd District.

Series at a glance

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☐	NOV. 18:	Ross Swimmer — The future BIA

Income from oil and gas royalties, in many cases, was collected for Indians by the government and placed in supervised accounts.

Interior Department reports from the turn of the century reflect a cavalier handling of the burgeoning Oklahoma Indian funds.

According to historian Angie Debo, Indians asked in vain for an accounting but documentation was scarce or non-existent.

A series of federal laws in the 1920s and 1930s strengthened earlier legislation which made it the government's duty to protect minerals on federal and Indian lands. However, there were few specifics on how that would be carried out.

IN 1959, the General Accounting Office reported serious deficiencies in the accounting procedures, the same problems which continue to exist decades later.

By 1977, annual royalty revenue climbed above a billion dollars a year and kept climbing.

Yet the honor system still reigned. Oil companies sent out checks to states and tribes with little fear the sums would be questioned.

In 1980, auditors reviewed only 3 percent of leases nationwide.

Utah Tax Commission Chairman David Duncan at that time conceded, when it came to checking on royalties, "We pretty much go hat in hand to the companies, take the check they give us, and say 'Thank you very much.' "

The Federal Oil and Gas Royalty Management Act of 1982 gave states and Indians hope that for the first time companies holding mineral leases would have to justify their payments.

Organization of the MMS to audit and collect funds was one result of the act. An explanation of payment to states and Indians was ordered.

But things did not improve. In fact, they got worse.

WHILE the oil patch thrived in the early 1980s, Indians and states with leases under production complained bitterly of not receiving payment or even being told where the money had gone.

Indians lost homes, had cars repossessed and utilities cut off while their checks were caught between computer glitches and bureaucracy.

By 1984, the Interior Department was under siege through numerous lawsuits.

Mary Limpy, a Cheyenne-Arapaho whose royalty payments dramatically decreased in 1983, filed suit in federal court with other Oklahoma Indians in 1985 asking for timely checks and an explanation of the payment.

She and her three children were evicted from their apartment four times and set up housekeeping in a van, according to a lawsuit filed in the U.S. court, western district of Oklahoma.

Her story was told before a congressional subcommittee in April 1985.

"Right now she doesn't even have a van to live in," her lawyer testified. "She lost it to a garage when she couldn't afford to pay the bill."

Yet, for the five months prior to the hearings, the gas well in which she held an interest had conservatively grossed $347,800.

Because federal records reflected what she should have been receiving from royalty payments, she was ineligible to collect state or federal welfare assistance.

OTHER lawsuits filed by Indians have recounted bad legal advice by the Office of the Solicitor which cost millions of dollars in lost bonuses and royalties.

Opinions by federal judges in several cases this year cite the lawyers' failure to live up to their trust responsibility.

Mineral leasing contracts were thrown out because the Indians had been forced to accept payment for a fraction of what their minerals were worth.

Several court cases repeated the theme of government siding with business.

In March, the government was ordered to pay more than $600,000 in damages to a Muskogee-area Indian. He had accepted a minimal sum for his lease bon when his government attorney failed get a current appraisal or inform him major production on the land, the cou ruled.

Solicitor Ralph Tarr, chief counsel fc the department, is studying that cour decision.

The judge "was suggesting the offic procedure was to defer to the oil company," Tarr said.

He recently wrote a memo to his attorneys reminding them "they were not t defer to any oil company attorney an they were to represent the Indian land owner and fulfill all of their legal responsibilities for a client."

ONE tribe battled the bureaucracy by training its own people to watch over its resources.

The Southern Ute Tribe of Colorado invested in computer equipment and hired a geologist and a petroleum engineer to review oil and gas programs and payments, the tribe's primary resource. They act as an adjunct to government services.

"With the exception of a handful of people in the Bureau of Indian Affairs, you really don't have personnel informed enough to provide the technical assistance we need," explained Tom Shipps, attorney for the tribe.

"We have been very pleased with our ability to grow in the last five or six years. It has been an unintended byproduct of government incompetence.

"There is a residual bitterness that the tribe had to assume these responsibilities because the BIA and the United States government were unwilling to perform their obligations."

States are no happier with the MMS acting as the auditor.

They cannot cross-check the amount paid by an energy company against the amount actually produced from leases onshore.

"It is still the honor system because you can't match a check to a production report," asserted Valdean Severson of the Wyoming state auditor's office.

From 1981 through this September, Wyoming collected $1.6 billion in royalties. Its 1986 share was $152 million.

Wyoming officials have identified $32 million in underpayments for that same time period.

Oklahoma never had audited federal leases until it began a three-year-audit cycle of the 560 now producing. It has a cooperative arrangement with MMS which provides funds and reviews the results.

So far, state auditors have identified $1.2 million in underpayments after auditing one-quarter of the leases. Most of the underpayments are from gas companies.

Charles Mankin, executive director of the Oklahoma Geological Survey, a state agency which promotes wise use of energy resources, helped author the federal study from which MMS evolved.

He suggests that one agency — either MMS or BIA — assume total responsibility.

"The Indian tribes need to know where to go," he said. "They get caught in this whipsaw between BIA and MMS, each blaming the other for what is going wrong."

IN ADDITION to the growing congressional clamor, Rep. Mike Synar, D-2nd District, said he will monitor both agencies during the next year through the General Accounting Office.

"People are afraid. They've lost a lot of confidence in the MMS and BIA.

"If you look at the number of complaints, there has been a substantial improvement since 1985," he said.

"I don't have any doubt that BIA and MMS are putting a better face on it than probably there is.

"Do I trust the BIA and MMS? No.

"Am I going back in and look? Yes."

Tribune special report: A Vanishing trust

The controllers

When a special Senate investigative staff examines Indian problems next year, it will be looking at "all parties involved with the collection of oil and gas royalties." Three Interior Department agencies often cross paths in that collection process.

Ralph Tarr, solicitor . . .

. . . is examining internal controls within his office in the wake of several opinions this year by federal judges, who reprimanded government attorneys for not watching out for Indians' best interests. "Based on these cases I want to review what we can do about accountability and be sure we have controls in place to preclude inadequate legal advice," he said. "Not that I think we have a major problem but I don't like even one case."

Ross Swimmer, BIA director . . .

. . . is facing several probes by congressional committees next year. "I would agree that the administration of Indian programs has been and continues to be plagued with many problems, program deficiencies and shortcomings."

William Bettenberg, director of the Minerals Management Service . . .

. . . hopes improvements in his system and his blueprint for the future will curtail critics of the 5-year-old agency.

"Some of our improvements are bigger than just small things. The result is that most of the money that comes in every month goes through our system and gets paid to the appropriate people."

'Dubious legal theory' sparks judge's ire

WHEN MOBIL OIL Corp. could not persuade a group of Indians to sign a contract for mining uranium, it simply rewrote the rules.

The new regulations forced lease terms on protesting Indian landowners and were approved in modified form by the Office of the Solicitor in the U.S. Department of the Interior.

Those guidelines were overturned in August by a federal judge who reprimanded government attorneys for concocting "a dubious legal theory."

"The Bureau of Indian Affairs and Interior generally seem to have been more concerned throughout the leasing process with their relationship with Mobil than their relationship with the Indian owners," wrote Senior U.S. District Judge E.L. Mechem of Albuquerque, N.M.

The Mobil case began in the early 1970s when the company was exploring for uranium in New Mexico using trust land alloted to individual Navajo Indians.

But Mobil was afraid of losing its lease.

According to the contract signed in 1972, the company had to get the project into commercial production within 10 years or the lease would go out for competitive bids.

By 1977, Mobil had spent $13 million on exploratory drilling and testing. It estimated the lease would produce 10 million pounds of processed uranium ore, known as yellow cake, with a market value of $350 million.

But it also realized it might not reach production by the date stipulated in the contract.

Mobil ultimately got the BIA area office to approve a new 10-year lease showing a minimum annual royalty rate of $20 per acre and a $16,000 bonus.

All of the Indian owners needed to sign the new contract but one-third of the landowners held off when an attorney advised them the lease terms were "sorely inadequate."

By 1979, Mobil had upped its offer to $216,000 in bonuses for the yellow cake it hoped to recover.

Yet a nearby lease on unrelated property, expected to yield 6 million pounds of processed ore, recorded a $10 million bonus, the judge noted in his opinion.

Despite repeated requests by the Indians, the BIA did not obtain an appraisal, court documents show.

Unable to budge the dissenting group of Indians, Mobil in 1980 wrote new rules and proposed them to the Department of the Interior. Those rules would allow the BIA to execute leases if the majority of owners already had signed.

It cited "unreasonable financial demands" of the holdout group.

The solicitor's office in January 1981 advised BIA that "common law principles of co-tenancy" provided a legal basis for contract approval without the consent of all owners.

Mobil had its new lease 10 days later. The BIA did not notify the landowners who protested.

When Judge Mechem voided the contract in August he declared that the Interior Department had breached its trust responsibility to the Indians.

His opinion stated that the BIA "has no inherent power to lease allotments without the owner's consent."

Mechem found it disturbing that "the BIA steadfastly resisted allottee requests for such an economic analysis."

He also noted that any BIA shortcoming "pales before this arbitrary and continuing refusal to exact of Mobil one jot more than Mobil originally offered."

No one in the BIA "so much as tried to determine how high Mobil was willing to go," he wrote.

The hopes of the landowners "were severed at the knees when Interior concocted a dubious legal theory ..."

The head of the Interior Department's legal section, Solicitor Ralph Tarr, is studying the case to decide if it will be appealed.

Tarr, who was not solicitor when the action was taken, said the department was placed in the awkward position of being trustee for two conflicting groups.

"What do you do when 35 percent say 'No' and 60 percent say 'Yes?' We are trustee for both," Tarr said.

Attorney Paul Frye, who represented the Indians fighting Mobil, said there is no dilemma.

"The fact that the majority of the people wanted to lease the minerals doesn't mean the trustee should let them lease for one-tenth to one-hundredth of their value," he said.

"The trustee has a duty to advise the people of the worth of the trust estate and not let people enter into improvident transactions."

Frye said the Indians will not become rich now even though the lease can be openly bid.

"The problem is that the BIA let the best opportunity for high bids pass right under their nose. The prices were good in 1979," he said.

"If you put it up for competitive bid now, it wouldn't benefit the allottees very much."

Frye's law firm has won other Indian cases including an administrative appeal involving a right of way with the Santa Fe Railroad in July. He said the cases point to a distressing pattern of big business prevailing with Washington bureaucrats.

"I fear that for every case where people are savvy enough to know they need a lawyer, there are 10 cases where people are cheated," he said.

Where has all the money gone? BIA gives up

WHEN the Office of the Inspector General tried to investigate what was thought to be a slush fund in the Oklahoma BIA office, there was one problem: Records spanning seven years were missing.

Despite exhaustive searches, the BIA still is unable to explain how much money flowed in and out of a mysterious money fund called the R.L. Larson account which surfaced in the Anadarko, Okla., office.

Newton Lamar, who was chairman of the Wichita tribe, stumbled upon the account in 1977. He was asking BIA what had happened to a $250,000 lease deposit owed by an oil company to his tribe, the Caddos and the Delawares.

As a BIA employee searched for his records, Lamar said he saw a ledger sheet listing special accounts, including more than $100,000 belonging to the three tribes and $154,000 to the Cheyenne-Arapaho.

Lamar testified about the fund in congressional hearings in 1985 chaired by Rep. Mike Synar, D-2nd District.

"I tried to find out what the account was and what it meant and what our money was doing in there," he said. "I was told that our money got in there accidentally."

Synar ordered a thorough search of the files.

Federal auditors culled records covering August 1964 to July 1985 to determine if it had been used as a slush fund.

The OIG discovered the R.L. Larson account was set up to handle various administrative fees that eventually were to be deposited with the U.S. Treasury.

According to Joe Walker, acting area director of the Anadarko office, the BIA collected money from oil companies and others as deposits for leases. Often, it would take months for a transaction to be approved.

The interest on that money, Walker said, was retained by the BIA to supplement the budget. He said the agency bought items not in the budget, such as typewriters, or paid for travel.

Larson 'was a man in the regional disbursement office whose name was used to create the fund.

The federal investigators reported to Synar in April that it was not a slush fund but said 47 transactions totaling $634,305 were inappropriate.

Another 10 transactions totaling $260,308 had insufficient or no documentation. Ledger entries were missing for Feb. 26, 1968, through April 9, 1973; Feb. 10, 1976, to April 20, 1977, and May 18, 1977, to June 21, 1978.

Only "massive research" would settle the issue, they concluded, but warned the cost would be prohibitive.

"There was a tremendous absence of records," Synar said. "Without the records, I've got to assume these were not unique cases."

Navajos weary of waiting for payments

MONTEZUMA Creek is in a remote area of southeastern Utah. There is no mail delivery to area homes. A few years back, mail began arriving at the local trading post, but many Navajos still drive 200 miles roundtrip to the closest BIA office for their monthly royalty checks to combine shopping with business.

Too often, the checks are not there.

Alan Taradash, an Albuquerque attorney, represents individual Navajos in a suit demanding that the secretary of the interior see that payments are on time and a clear explanation of what is being taken from the ground by oil and gas companies is provided.

"Our people live in very rural settings. They don't have telephones, there are no paved roads, no running water. They don't have electricity. They haul wood for heat," he said.

"We have people who are living on a royalty check which may be as little as $100 a month. When that check does not come in on the day they are told it will be there, it is an extreme hardship."

The trip to the BIA office can be frustrating.

Taradash said the process involves filling out paper and then waiting for the superintendent to review the account.

"Now, if all goes well, that can take all day. If it does not go well, you don't get a check. You've spent an enormous amount of money just to come and go."

He said royalty payments have come in five and six months late and his clients have been shunted between Minerals Management Service and BIA as they search for an explanation.

"It is just such obscene behavior that I cannot begin to tell you the emnity I hold for the government and its employees. There is no accountability."

With the latest payment, Taradash said one of his clients received no explanation of payment as required by law.

Another received a new interim form and then later got an older and different explanation-of-payment form.

"She is totally confused," he said.

Royalty checks in October arrived late for Indians across the country.

Walker said the problem stemmed from "mechanical and human" foul-ups.

MMS sent the money to BIA's Albuquerque repository Oct. 19, three days late. Then, the BIA had problems getting the money out to area agencies.

Sam Wilson, spokesman from the MMS Lakewood, Colo., office, said the checks were sent out on a Monday instead of a Friday because of some problems with a new computer.

"They didn't consider that as late," he said.

Court awards for Indians bittersweet

A
Vanishing
trust
Tribune special report

By EDWARD M. EVELD,
MARY HARGROVE
and GRANT WILLIAMS
Tribune writers

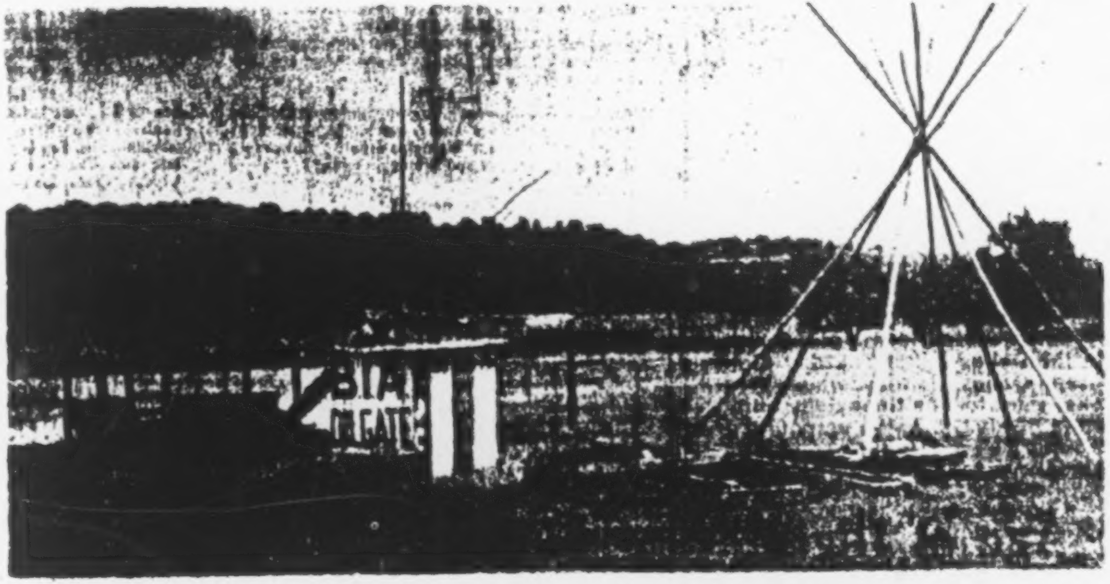
INDIANS who depend on mineral revenues for survival have been forced into federal courtrooms where they are winning in multimillion dollar contract disputes.

But the victories are bittersweet.

The Bureau of Indian Affairs, the federal agency charged with protecting their rights, has saddled them with financially devastating agreements and costly courtroom battles.

In several instances, the BIA blocked western Oklahoma Indians from leasing their land to new bidders offering 10 to 20 times what producers originally paid for drilling rights.

The result has been millions of dollars out of reach to Indian mineral owners; some have died



Protest site

Tribune photo by Sherry Brown

Indians near Anadarko erected a tepee and campsite outside the Bureau of Indian Affairs office in 1983 to protest late payment of their oil and gas checks.

waiting for the cases to be settled.

By federal law, Indians cannot sign contracts on land held in trust without BIA approval.

Bureau decisions in some cases added to the economic hardships of many Indians in the Anadarko region, which has an estimated 36 percent unemployment rate among Indians and little industry to bolster the economy.

"It's sort of a starve-out situation," said Amos Black, an Anadarko attorney who represents Indians. "It's a crime, really."

The problems go back five years to the oil and gas boom days when mineral discoveries made millionaires overnight, and producers scrambled to entice landowners to sign contracts.

Indians who thought they could overcome their hardscrabble existence in western Oklahoma saw that opportunity slipping away. They blamed the BIA.

"Here you are, stuck on this scruffy land that you may have been leasing out for a few hundred dollars a year for hay farming," said Patricia Brown, a Washington, D.C., attorney.

"This is your chance in life . . . to catch that one gold ring. It doesn't come back again. Once the boom is over, that opportunity will never arise again."

Several of the recent court disputes center on communitization agreements, a procedure used by oil companies to combine leases.

Brown represented Newton Rose and other members of the Rose family, which owns 80 acres of federally protected Indian land in Caddo County. Here is how she describes what went wrong.

Oil companies leased land from Indians for a period generally of five years. According to

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terms, if the company did not have a well in production by the expiration date, the Indians were free to negotiate new leases.

Competition for leases meant energy companies were willing to pay higher and higher bonuses for the privilege of drilling.

Landowners who received $100 an acre in the early 1970s raked in new bonuses of $2,000, $3,000, up to $10,000 an acre

But some energy companies rushed to the BIA with requests for communitization agreements. That kept the Indians from negotiating new leases or fielding bids from competing companies.

In such agreements, the energy company is allowed to use one well to pump oil and gas from several properties, and all owners share in the proceeds. There is no reason to drill four or five wells when one is all that is needed.

Once approved by the BIA, a communitization agreement has another effect. It extends the life of an oil and gas lease indefinitely, as long as there is drilling activity.

IN THE case of the Rose family, on Jan. 15, 1982, Cotton Petroleum Corp. approached the Anadarko BIA office requesting a communitization agreement.

The Rose family's lease with the oil company was to expire two days later.

Company officials "rush in on the last day or a couple days before that. They don't really have a well there. All they're doing is raking a little dirt," Brown said.

The Anadarko BIA office considered Cotton Petroleum's request, then approved the communitization agreement on Feb. 11, 1982, retroactively reviving the expired lease.

"Now the Rose family has just lost hundreds of thousands of dollars," Brown said.

By the BIA's own estimate, which the Roses contended was too low, the family would have received a bonus of $109,200 in March 1982 if the lease had been bid.

The Rose family took the case to court. It was dismissed because the Indians had failed to exhaust administrative appeals within the BIA.

The case lumbered through the Interior Department appeals process for two years. On Jan. 13, 1984, Kenneth Smith, then head of the BIA as assistant secretary of Indian Affairs, ruled in favor of the Rose family.

"It is clear that approval of the communitization agreement as to the lease of the Rose tract is not in the best interest of the Indian lessors."

IN THE meantime, Cotton Petroleum had pumped oil and gas from their property and the Roses wanted their share of the proceeds. But Brown said the BIA, entrusted with keeping the records for Indians, refused to turn over the production reports from Cotton.

"Remember, these are the people who own this property. We have to apply under the Freedom of Information Act to find out whether the well is producing," she said. It was.

"So you think, justice has prevailed and the Indians will get their money," Brown said. "No way. Cotton does nothing. It simply refuses to obey the assistant secretary's order."

When Smith threatened Cotton Petroleum with penalties, the company took the case to U.S. District Court in Oklahoma City — and lost.

Early this year Cotton appealed to the 10th Circuit Court of Appeals in Denver. Brown said about $250,000 in oil and gas proceeds remain in an escrow account pending the outcome of the case.

Five years have passed since the Rose family first pleaded with the BIA not to squander their opportunity for a new lease and big bonuses.

"The Indians have yet to receive a penny," Brown said. "They've now prevailed before the assistant secretary; they've prevailed before the (U.S.) District Court. But they've gotten nothing from it."

BLACK, the Anadarko attorney, represented a group of Indians in a similar case. The Indians owned 117 acres in Custer County.

Woods Petroleum Corp. came to the BIA in February 1982, days before its lease with the Indians would expire, and requested approval of a communitization agreement.

That week, several of the Indian owners delivered to the BIA written objections to approval of the agreement:

"It is in my best interest to allow the current oil and gas leases to expire, and then to have these properties advertised for competitive oil and gas lease bids at the next oil and gas lease sale conducted by the Bureau of Indian Affairs," the statements read.

Nevertheless, the acting area director at the BIA in Anadarko, Charles V. Delaney, approved the agreement on April 12, 1982. He made the approval retroactive to January, when Woods had begun drilling a well on non-Indian land within the combined tract.

This occurred, Black said, at a time when companies were paying bonuses as high as $3,000 an acre on new leases in the area.

Further, the Indians never were told their old leases with Woods had been revived.

"They didn't get notice of anything," Black said. "As a matter of fact, they have never gotten notice of the communitization agreement."

But the Indians eventually learned of the agreement by word of mouth and sought help from Black. On Oct. 3, 1983, he filed their appeal with the head of the BIA in Washington.

Eleanor Thompson
..assistant U.S. attorney

ROSS SWIMMER, who had succeeded Smith, ruled in favor of the Indians nearly three years later on May 15, 1986.

"After a careful economic analysis and after review of the record, I find that the area director did not act in the best interest of the Indian mineral owners when he approved the communitization agreement," Swimmer wrote.

He dismissed an argument — used by energy companies and local BIA officials — that rejecting communitization agreements would drive producers away from investments on Indian-owned land.

He cited evidence that another oil company, even without competitive bidding, was willing to pay the Indians $400,000 in bonus money for the right to drill.

Woods sued the Interior Department in U.S. District Court in Oklahoma City. As the litigation continues, some $460,000 sits in escrow accounts at the BIA and with the court, Black said.

"They've never been paid a penny," he said.

KENT L. JONES is an attorney with the Tulsa law firm of Hall, Estill, Hardwick, Gable, Collingsworth & Nelson, representing the oil companies in these two cases and in two similar lawsuits. He declined to comment, saying he would not discuss cases in litigation.

Series at a glance

☐ **MONDAY:** Austin Walker — A case of the wrong man
☐ **TUESDAY:** The System
■ **WEDNESDAY: Battles in Court**
☐ **THURSDAY:** The Bureau of Indian Affairs in Oklahoma
☐ **FRIDAY:** The Money Watchdogs
☐ **MONDAY:** Disputes over the Land.
☐ **TUESDAY:** The Osage and the Cherokees
☐ **WEDNESDAY:** Ross Swimmer — The future BIA

Eleanor Thompson, an assistant U.S. attorney in Oklahoma City, has represented the U.S. Interior Department in four such cases.

In the suits involving Woods and Cotton, she is in the difficult position of defending a bureaucracy that first ruled in favor of the oil companies, then reversed itself.

Thompson said local BIA officials argued they were protecting the long-term economic interests of Indians by approving the agreements. They feared that if the agreements were rejected, oil companies would not drill on Indian-owned land at all.

Thompson rejects that reasoning. "My mind tells me that if there is money to be made, somebody is going to make it. Nobody is going to ignore oil coming out of the ground simply because they have to ask for a communitization agreement the correct way."

She added, "The bottom line is money. Money is the motivating factor. The Indians haven't gotten any."

FAULTY BIA decisions that benefited energy companies rather than Indians are not limited to Oklahoma — or to oil and gas.

In August, Senior U.S. District Court Judge E.L. Mechem in Albuquerque issued an opinion criticizing the Interior Department's handling of a uranium lease between Mobil Oil Corp. and five Navajos who own property near Crownpoint, N.M.

The judge ruled the lease void, saying the BIA arbitrarily changed the rules governing lease approvals and kept an Indian family from earning a fair bonus.

Mechem agreed with recent conclusions of other federal court judges that Congress granted the government a "pervasive role and comprehensive responsibilities in mineral leasing" on Indian-owned land.

The government's job: to ensure Indians receive "the maximum benefit from mineral deposits on their lands through leasing."

The same month Mechem issued his opinion, Indians began to question anew the BIA's intentions when the bureau published proposed leasing regulations.

They were to be finalized in September but were hastily withdrawn for 90 days after complaints from Congress.

THE PROPOSED oil and gas rules would erase the progress Indians have made over the past

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five years in federal court, according to two critics.

The proposals state that the economic interests of Indians generally will not be a factor in deciding whether to approve communitization agreements.

Suzan Harjo, with the National Congress of American Indians, said these regulations in effect would overturn five federal court decisions that sided with the Indians.

The proposed regulations read as though they were lifted directly from the oil companies' losing arguments in court, Harjo said.

The rules, in what detractors consider upside-down logic, place the blame on Indians for trying to thwart oil companies. They read in part:

"The purpose for pooling mineral interests is to promote conservation and efficient development of the resources.

"However, during the early 1980s, when speculation for oil and gas properties caused bidders to offer extremely high bonuses, many Indian mineral owners put pressure on BIA officials to either not act on, or disapprove, cooperative agreements for the sole purpose of causing the primary terms of leases to expire so the lands could be re-leased and new bonuses received.

"The Department believes that the review process should be limited to the technical aspects of whether or not the proposed agreements provide for proper operational concerns."

THORNTON W. Field, an assistant solicitor with the U.S. Solicitor's Office in Washington, called the critics' arguments "fallacious" and "disingenuous."

The purpose of a communitization agreement is to facilitate oil and gas production, not to open negotiations for new bonuses and royalty rates for property owners, he said.

Once the Indian lessors sign a lease with an oil company they are "getting what they bargained for," he said, regardless of whether the company requests a communitization agreement during the first year of the lease or several months before the lease is set to expire.

However, the department has taken steps to prevent last-minute dashes for communitization agreements, Field said.

A rule took effect in 1983 requiring that agreements be requested at least 90 days before the expiration of the leases. That provision remains in the recently proposed regulations.

Also, the department has shortened the time given oil companies to begin production. Since the late '70s in the Anadarko region, the department has required three-year leases with Indian property owners, even though the law allows leases up to 10 years.

"We've really put these people under the gun to get into development in a very short period of time," Field said.

ATTORNEY Brown is furious about the proposed regulations. She feels the BIA sneaked in the rules, allowing four years to pass between the time the proposed regulations first were discussed and the final rules that were to take effect in September.

"Those regulations were issued in final form — no further opportunity for public comment — during a congressional recess. Very nice timing."

Swimmer said there was nothing furtive about the proposed regulations; they had been published in the Federal Register.

He said he had not even seen them until he received a call from U.S. Rep. Sidney Yates, D-Ill., who watches the agency in his role as chairman of the House Appropriations Committee.

Swimmer said as soon as Yates complained, he told the staff to hold up final approval for additional comment.

"We will be looking seriously, and I really do mean seriously, at any comments that are submitted," said Field. "And if the Indians think we're doing something wrong, we'll look at that very carefully."

Given the history of how well Indians have fared in the hands of the federal government, Brown said, she cannot be optimistic.

Until the BIA becomes more diligent in reviewing oil company actions, she warned, the only hope for Indians is in the courtroom.

"The courts have been truly the last bastion of Indian defense."

Voices from the past ....

1906 – Pleasant Porter, chief of the Creek Nation

NEARLY 81 YEARS ago, an Oklahoma tribal leader sat down before a group of congressmen and spoke from his heart.

The words came slowly and sadly with a vision of the anguish yet to come.

Pleasant Porter, chief of the Creek Nation, deplored the government's "protection" of Indians by dividing up their lands.

"It was a mistake to have changed these people's relations with the government," he intoned.

"The Indians haven't had time to grow up to that individuality which is necessary to merge them with the American citizen.

"The change came too soon."

Porter in 1905 was elected president of the Sequoyah constitutional convention at Muskogee which unsuccessfully fought to establish a separate Indian Territory from the state of Oklahoma.

"There will be a remnant that will survive but the balance is bound to perish, do what you may for them. Evolving a thing out of itself is natural — transplanting it is a matter of dissolution, not growth."

"But we came up against it. This civilization came up against us and we had no place to go."

The chairman addressed the chief.

"You told us a moment ago they were dying off pretty fast?"

"Yes, sir, the older people are."

"Is there any special cause?"

"Nothing. There is no new disease. I don't see anything other than the want of hope."

1936 – Angie Debo, author

KIDNAPPING and embezzlement were weapons used more than 50 years ago to separate Indians from their oil and gas money.

Author-historian Angie Debo, now 97 years old, recalls her anger as she researched a book on the betrayal of the Five Civilized Tribes by guardians, attorneys and corrupt state and federal officials.

Her stories in "And Still The Waters Run" provide an eerie backdrop to current investigations and lawsuits involving the misuse of Indian monies.

Debo discovered guardianships were a prime area for illegally siphoning funds.

"Forgery, embezzlement, criminal conspiracy, misuse of notary's seals and other crimes against Indian property continued with monotonous regularity," she wrote.

"But these grosser and slightly more dangerous forms of swindling were not as common as the more respectable methods of investing Indian money in worthless real estate, padding guardians' accounts ..."

Young Indians were kidnapped before they reached legal age, hidden in hotels or taken out of the country. They then were "induced to sign deeds at midnight on the morning they became of age," she wrote.

"A woman who secured an oil lease in this way boasted that she had travelled over three thousand miles with her young prospect, evading his brother, the county judge and federal secret service men who were hot on her trail."

Debo recounted in a recent interview, "I had lived in Oklahoma and I didn't know I was going to run onto these things. I was profoundly shocked at what I found."

The manuscript was the idea of Joseph Brandt who founded the University of Oklahoma Press. It was completed in 1936.

Debo said the stories of political corruption linked to the cheating of the Indians were scandalous in that era.

"We took measures to protect the press against the hostility that would arise after the book was published," she said.

But Debo withdrew it before it could be printed.

"I knew if that book had been published by the OU Press, the Legislature would have destroyed the press," she said.

When Brandt, a former city editor of The Tulsa Tribune, was hired to direct the Princeton University Press in 1938, he called Debo and told her to bring her manuscript. It was published in 1940.

"Mr. Brandt had the strongest feeling, as strong as my own, that any person should tell the whole truth, no matter what the consequences are."

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Tribune photo by Sherry Brown

Eddie Jacobs stands beside his oil well near Drumright. He works with Indians across the state to get audits of oil and gas payments.

TULSA TRIBUNE

NOV 13, 19[illegible]

Billion-dollar headache

Agency collects, accounts for Indian money

By GRANT WILLIAMS,
MARY HARGROVE
and EDWARD M. EVELD
Tribune Writers

A
Vanishing
trust
Tribune special report

THE Minerals Management Service is a small federal agency with a billion-dollar image problem.

When oil, gas, coal, uranium or a host of other minerals are produced on protected Indian or federal lands, MMS collects and accounts for the money.

But MMS has drawn the wrath of the press and some powerful politicians.

In April, the Washington Monthly magazine dubbed it "Washington's worst run program."

"The standing joke among those involved in royalty management is that after 33 years of trying to correct the program's problems, it still takes 10 bureaucrats to collect royalties," wrote John Eisendrath.

"One to underestimate the amount owed and nine to make sure the payments get screwed up."

MMS Director William Bettenberg drafted an angry letter to the editor expressing his "great disappointment" at the facts the writer "so faithfully exaggerates for your readers."

THE 47-year-old Bettenberg admits there is more to do, but he resents those who do not acknowledge the program has improved.

Since 1982, the little-known federal agency has collected $387 million in previously unreported oil and gas royalties from energy companies.

But the Minerals Management Service can do anywhere from $300 million to $1 billion a year better, its critics insist.

MMS is a branch of the U.S. Department of the Interior.

Rep. Sidney Yates, D-Ill., chairman of the House Appropriations Committee, lashed out at MMS during a congressional hearing a year ago.

"I must tell you in utter candor and frankness, I am just appalled by what is happening in MMS; not just by what is happening, but by what is not happening," he told Bettenberg.

Yates brandished an investigative report by staff members who examined leases and underpayments in four Western states. They concluded underpayments averaged 21 percent.

The staff estimated MMS collections could be short by as much as $5.8 billion since 1979 if applied to all states.

BETTENBERG later scoffed at the figures, saying revenues lost were approximately 3 percent. He did not pinpoint a dollar loss but retorted "our auditors say it can't be anything like that."

He charged that Yates could not back up his "flawed information" from such a limited review and termed any billion-dollar price tag "laughable."

Charles Mankin, executive director of the Oklahoma Geological Survey, has chaired an MMS advisory committee.

He, too, has worried about what is not being detected.

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TULSA TRIBUNE

Indian

From page 1A

"Nobody knows. No one has ever really done a careful statistical sample," he said.

Determining just how well MMS does its job will be the first priority next year for a special investigative staff.

The Senate Select Committee on Indian Affairs voted two weeks ago to seek $240,000 for the first three months of a probe of Indian programs in the Interior Department including the question of royalty underpayments.

REP. Mike Synar of Oklahoma, D-2nd District, noted the MMS complaint level is down significantly from two years ago, but labels improvements "baby steps."

"There's no doubt that there is a black hole in which a lot of things tend to fall," he said.

Mankin believes those judgments are too severe.

"MMS has made phenomenal strides in the last couple of years to get its act together," he said. "It doesn't mean they don't have a way to go, but it doesn't mean they haven't made great strides."

An unlikely MMS ally surfaced in September in the form of Sen. William Proxmire, D-Wis., famous for presenting his Golden Fleece Award to wasteful Washington programs. He urged MMS critics to tone down.

"Instead of a lashing, they deserve a pat on the back for beginning to do a difficult job well," he said.

THE debate is critical to energy states like Oklahoma and to thousands of Indians.

Last year, total royalties, rents and bonuses paid by energy firms were $3.7 billion. Indian oil royalties dropped 43 percent while federal onshore oil royalties fell 45 percent following the dramatic drop in oil prices.

Oklahomans garner a significant percentage of the minerals funds because 51 percent of all Indian leases in the country are in Oklahoma.

Individual Indians and tribes in Oklahoma have received $146 million from oil and gas leases during the past five years, not including $173 million collected by the Osage Tribe which has its own system.

In addition, MMS has recovered more than $1.2 million in underpayments and interest for Oklahoma Indians and tribes in audits over the last three years.

Vernon Ingraham

MMS has been a controversial department since it took over the accounting function from the U.S. Geological Survey (USGS) in 1982.

A special study group, the Linowes Commission, examined the problems of USGS a year earlier and pronounced, "Management of royalties for the nation's energy resources has been a failure for more than 20 years."

It called for a "thorough overhaul" of the system, adding, "oil and gas companies must be held accountable."

Mankin was an author of the report.

"There is no question that calling USGS inadequate was a generous statement," he said.

MMS evolved from the 1982 Federal Oil and Gas Royalty Management Act which gave states and Indians hope that there would be some checks and balances.

Its first step was, by all accounts, a disaster.

Despite warnings by a consultant that the agency needed major capacity to store data on 24,000 leases, a mini-computer was installed. It was running at capacity with only 10 percent of the information typed into its system.

MMS only could run from behind for the next five years.

AFTER adding a roomful of mini-computers to expand the computer capacity at a cost of $50 million, another $32 million was spent on a larger IBM mainframe.

The much-larger IBM went online in September, a year and a half late.

If the computer lagged badly, it also was several years in the field before the accountants geared up.

Energy companies had been on an honor system: The checks to landowners were accepted without explanation.

With the 1982 act, payment was accepted "subject to audit."

The problem was, the audit schedule was sporadic, and Indian leases, which represented 3 percent of total royalty revenues, were not a high priority.

IN 1985, Synar invited Oklahoma Indians to appear before his energy subcommittee.

They testified they were not being paid royalty monies by energy companies while their pleas for audits were ignored.

Synar had first-hand experience with being brushed aside.

His request that specific Oklahoma Indian leases be audited was "lost" in the MMS Lakewood, Colo., headquarters for almost a year although he had been assured by MMS officials that the audits were progressing.

"The first impression I had was, 'Here are the people who really were being cheated, and we were seeing severe economic consequences.'

"It was very clear to me the system was broken, and that major overhaul was necessary. There had not been any sense of direction or commitment on that."

BY THAT time Bettenberg, a career government employee and director of the agency since 1983, had gone into action.

He sent MMS representative Vernon Ingraham to troubled areas such as Anadarko, Okla., to discuss complaints.

A 31-member advisory committee comprised of industry, state auditors and Indians began to meet in Lakewood to hash out differences.

He made Indian leases an accounting priority, setting a six-year audit cycle.

In five years, he hired three directors — and removed two — at the Lakewood headquarters as he tried to find the right person to ramrod the program.

TULSA TRIB[illegible]

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But some major stumbling blocks to money collections identified in 1981 have dragged on uncorrected.

Bettenberg and Yates tangled in September 1986 over the failure of MMS to write new valuation regulations for oil, gas and coal.

That is a continuing problem because state auditors and industry auditors were interpreting the vague rules, which helped set the price of the product, to each one's best advantage.

AUDITS produced vastly differing results depending on who did them, tying payments up in lengthy appeals.

Yates: "How in the world can a company presently know whether it is complying with what you expect them to do? Isn't it total chaos?"

Bettenberg: "It is not total chaos."

Yates: "It is just chaos."

Bettenberg: "There is a certain amount of chaos out there." ...

Proposed value regulations were submitted in 1986 and examined for a year by the MMS advisory group. The members could not come to an agreement.

Drafts of the regulations were published in early 1987 and again in August.

But Yates held the final rules up for several months so they could be modified. They should go into effect after the first of the year.

MMS officials said a major portion of the $387 million in underpayments stemmed from misreading the old regulations.

MMS is bracing for protests from states and tribes on the new guidelines.

"They are concerned their money will drop and that is legitimate," said MMS Lakewood director Jerry Hill.

"But we don't see our charge as one to maximize income.

"If you get the money now and then industry reaches its economic limit, you get less money overall."

Alan Novins, a Washington, D.C., attorney who represents the state of California in oil and gas matters, fumes at the idea.

"Instead of a lashing, they (MMS) deserve a pat on the back for beginning to do a difficult job well."

— Sen. William Proxmire
Wisconsin Democrat

On transferring MMS to the Internal Revenue Service: *"I don't like the IRS. That's like trading a wolf for a coyote when you're guarding the sheep."*

Ben Nighthorse Campbell
Colorado congressman

"They say states and tribes should not push to get their full legal rights and money because we have to be concerned about the welfare of the oil industry," he said.

"As long as MMS feels its highest priority is to protect the industry, it is not going to come up with anything that is going to satisfy the needs of the tribes and the states."

ALSO unsettled is how much and what kind of information the government should provide to leaseholders.

Many find the explanation of payments unreadable, a collage of meaningless figures.

Alan Taradash is an Albuquerque attorney who represented Navajo allottees in a class action suit filed in 1984. They demanded the secretary of the interior see that payments were timely and provide an understandable explanation.

"We had Arthur Andersen & Co. take a look at it (the form), and they couldn't understand it. The General Accounting Office reviewed it and found it hard to understand. The simple fact is that some of the information is downright misleading."

What is termed "production" information on the form rankles states and tribes. It lists production only after minerals are sold, not what comes out of the ground.

"They've argued that production means reported sales. Well, that's just nonsense," Taradash said. "That's not at all what the law requires."

In addition, a production figure may be a composite of several different numbers rolled into one.

Accountant Valdean Severson of the Wyoming state auditor's office said a manufacturing allowance on gas, transportation on gas, and taxes may be rolled into one number, making audits impossible.

"They are supposed to break it out line by line to tell you what happened on the lease," Severson said.

BETTENBERG argues his agency is technically in compliance with the law by providing a production figure.

"We do provide them with a number but the number isn't really the relevant one all the time. We need to do better than that.

"We did the best we could to get an explanation of payment sent out. While a prettier and more easily readable form would have been a nice thing to do, it was beyond our capability with the computer. By far, it is not the most important thing to be done."

Bettenberg noted that each month MMS processes 4,000 checks and $400 million in royalties.

He labeled MMS as "essentially a brand new operation in government" and said he is pleased with its progress.

"The single most important thing is that the organization has been maturing. It has been learning from its mistakes, discovering new problems and going to work on curing them."

JOHN SIMONETTE of the General Accounting Office told a congressional subcommittee in April that MMS has made "a dramatic difference" and pointed to "noteworthy progress."

But he said GAO has "serious questions" about MMS and its ability to collect a fair royalty amount.

MMS auditing — or failure to audit — remains at the core of the most severe criticism.

Several congressmen suggested MMS be transferred to the Internal Revenue Service, an idea dismissed by Rep. Ben Nighthorse Campbell, D-Colo., the only Indian member of Congress.

"I don't like the IRS. That's like trading a wolf for a coyote when you're guarding the sheep," he said.

A group of Indians has formed the Oklahoma Indian Mineral Owners Association to question MMS payments and push for audits.

Eddie Jacobs of Oklahoma City is a board member who has received more than $20,000 in underpayments from energy companies after he insisted MMS audit the leases.

"Until we came along with the association, all there was were arguments going on ... without getting anywhere," he said.

AS THE agency struggles to keep ahead of the complaints, its history plagues its every move.

Another Interior Department agency, the Bureau of Land Management, verifies the amount of production for onshore leases.

TULSA TRIBUNE

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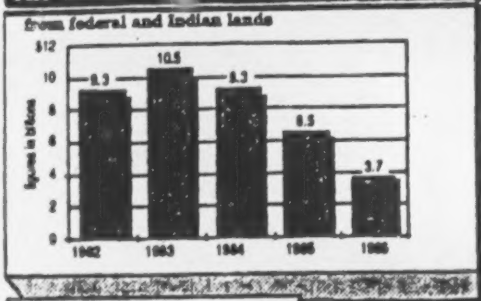
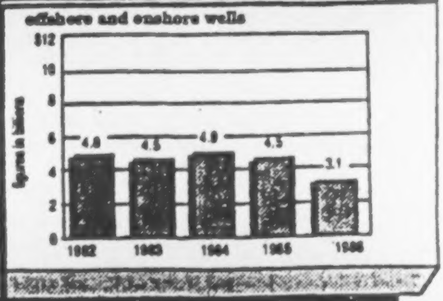
Living off the land

Revenues and royalties from federal and Indian lands

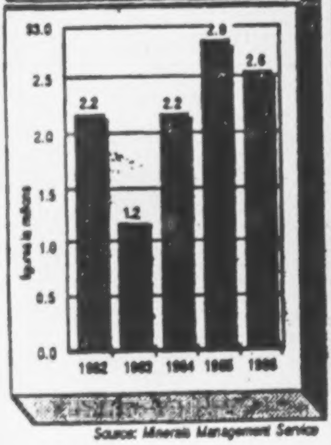
All mineral revenues



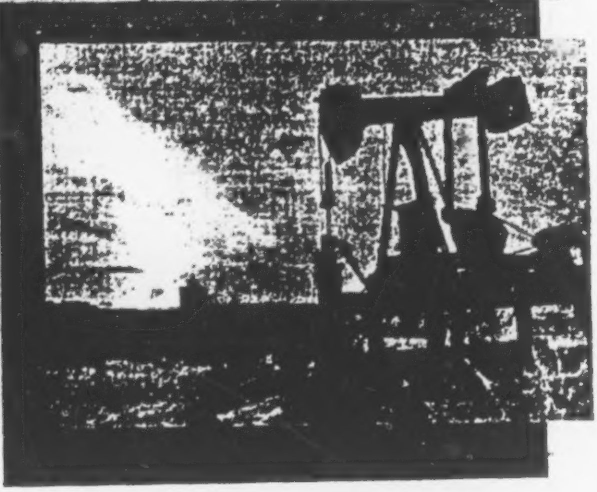
Oil and gas revenues



State of Oklahoma's share



Source: Minerals Management Service



TULSA TRIB

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But there is no computer link with MMS to match against the payments.

Bettenberg announced a connecting program would be phased in between March and September 1988, but recently placed it on hold due to a lack of funding.

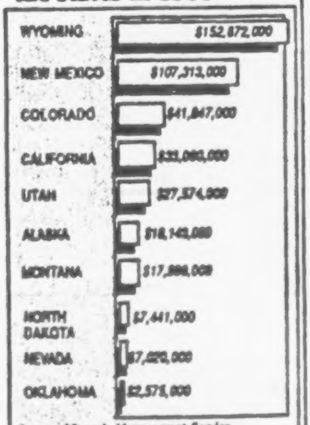
Critics saw it as more of the same unfulfilled promises.

"Matching up production with what is paid is the first step in basic accounting," Wyoming's Severson said. "I would say when you haven't done that for five years, you're a little late already."

Yates plans to watch MMS, saying congressional committees share the blame when agency problems drag on for years.

"Unfortunately," he said, "it's a task that requires almost constant supervision, and Congress can't give it."

Mineral revenues paid to the states in 1986



Source: Minerals Management Service

Tribune graphic

Indian oil and gas revenues from 1981 to 1986

1. Utah	$193,159,233
2. Oklahoma	145,811,830
3. New Mexico	92,403,339
4. Wyoming	88,062,208
5. Montana	27,396,128
6. Colorado	26,458,454
7. Arizona	3,242,562
8. North Dakota	2,152,566
9. South Dakota	65,382
10. Michigan	32,928
Total	*$580,786,409*

Source: Minerals Management Service

Tribune graphic

Tribune special report: A Vanishing trust

Direct pay: Indian leaseholders' controversial option

INDIANS who don't trust the Bureau of Indian Affairs to handle their royalty checks have an alternative called direct pay.

But that highly controversial option pits Indians and federal officials against each other. The Indians even disagree among themselves.

The debate has intensified in the past two years since Ross Swimmer became head of the BIA. A former Cherokee chief from Tahlequah, Swimmer has watched the direct pay system succeed in Oklahoma and is a staunch advocate.

About 1,500 direct payments are made to eastern Oklahoma Indians each month out of a total 4,000, BIA officials say.

MOST American Indian landowners receive royalty money through indirect pay.

Energy companies each month send payments — allotted to each oil and gas lease — to the Minerals Management Service, a branch of the U.S. Department of the Interior, in Lakewood, Colo.

MMS records the transactions and forwards the money to the BIA.

The BIA calculates the appropriate royalty for each Indian on each lease and writes and distributes checks.

Under direct pay, oil and gas companies send payments straight to the Indians who own land under production.

The energy firms keep track of each Indian's share, and send copies of the transactions — not the money itself — to Minerals Management for use in future audits of production.

The BIA's role is reduced to helping direct pay recipients with problems by contacting the MMS and energy companies in their behalf.

ALL Indians are eligible for direct pay, said Swimmer, who encourages them to sign up to spare their money from a trip through bureaucracy.

"They get the same cash," Swimmer said. "It's just that they get it quicker . . . anywhere from 30 to 45 days earlier."

However, Nick Kelly, head of MMS's Tulsa compliance division, worries that Indians "give up a lot" with direct pay because it eliminates a second tier of government supervision over oil company payments.

"If I were BIA, I would say direct pay is great. It reduces (their) work," Kelly said.

"The BIA is sitting there saying if you've got direct pay, you're on your own."

Swimmer disagrees. "We're not getting rid of a lot of our paperwork."

Joe Parker, head of the BIA's Muskogee office, acknowledges that under direct pay, "We don't know that lessees get their money."

But, he said, "If they don't, normally they'll be coming in and checking on it (and) hollering at us."

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TULSA [illegible]

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THE bureau encourages those with direct pay complaints to ask for assistance, said Jack Chaney, another official at the Muskogee BIA.

"It's still our responsibility."

Phillips Petroleum Co., which mails 99 direct-pay checks to Indians each month, is less than enthusiastic about the concept.

Mark Quinlan, Phillips' senior royalty administrator, said his company tires of tracking all the Indians and their descendants who have royalty interests.

Indian leases are complicated, he said, because they sometimes have more multiple owners than non-Indian properties.

"We think the BIA responsibility is to get the money to the correct Indian," Quinlan said, because the bureau keeps better records of Indian families and where they live.

OKLAHOMA'S Indians also have split over the issue.

Direct pay scares landowners such as Berdena Holder of Gracemont in western Oklahoma, who now receives indirect pay.

Holder doesn't trust oil companies to pay correct royalties and report them to MMS. She fears direct pay encourages government to break its promise to watch over oil and gas production.

Holder also thinks direct pay could create more problems with royalties than Indians face now.

"If this doesn't work, what are they going to do with us?" she asked.

Juanita Learned, an official of the Cheyenne-Arapaho tribe in western Oklahoma, said direct pay appeals to Indians who are fed up with the BIA's handling of their money.

But she said the bureau should improve its performance rather than abandon its role as overseer of royalty payments.

"The bureau just can't give that up."

ROD DUROSSETTE, a Creek Nation official in Okmulgee, said the speedy delivery of royalty checks under direct pay is attractive.

"One family member on direct pay might get his check today while his brother on indirect pay may not see it" for weeks, Durossette said.

In the past, Minerals Management recommended direct pay to Indians, said its national director, Bill Bettenberg.

The agency backed off after a poll of Indian leaseholders showed strong resistance to the change.

"Those who were under direct pay thought direct pay was great," Bettenberg recalled.

"Those who weren't already under it said, 'Over our dead bodies.' "

A Vanishing trust
Tribune special report

U.S. solicitor's actions puzzle officials

By EDWARD M. EVELD,
GRANT WILLIAMS
and MARY HARGROVE
Tribune Writers

HAROLD WADE was reviewing lawsuits when he spotted a troubling legal twist among the court papers. He alerted his bosses.

Wade hadn't seen anything like this in 14 years with the Bureau of Indian Affairs.

Landowners in north Tulsa County wanted to claim an Indian family's mineral interests by citing underground squatter's rights — something for which there seemed to be no precedent.

The BIA realty officer felt certain the lawsuit, if unchallenged by the government, could set the stage to deprive hundreds of eastern Oklahoma Indians of lucrative oil and gas holdings.

The case also stunned him because the property owner stated in a court document that oil already had been pumped from the land.

The Indian mineral owners had not granted permission to drill by signing a lease, which then requires state court approval.

There were no records of a court hearing and, more important, the Indian owners never had been paid oil and gas royalties.

It was the government's role to find out why.

BUT Wade was opposed by government attorney Rex Herren, second in command at the solicitor's office, which provides legal advice to the BIA.

Herren's actions in this case later would be investigated.

Wade's zeal in pursuing the case elicited hostile rebukes from his bosses who told him to drop the matter. He did not.

Finally, he was hit with a two-year reprimand, punishment for talking to a Muskogee newspaper reporter about the case, his supervisor claimed.

The 48-year-old Wade said he didn't know where else to turn.

Wade's crusade began in 1982 when he spotted the court case involving the heirs of Susie Chewee Blackwood, a Cherokee.

James E. Wolfe and other family members, owners of the surface property on a tract in north Tulsa County, claimed title to the Blackwoods' one-half mineral interests underneath 30 acres of the Wolfes' property.

THE Wolfes based their claim on the legal notion of adverse possession, more commonly referred to as squatter's rights.

Title to a piece of property can be taken from the owner of record, according to state law, if a person can show open and uninterrupted use of the land for 15 years.

But squatter's rights on Indian minerals, which are underground and granted special protection by the federal government?

"It's common to see surface lands taken by adverse possession in quiet title suits," Wade said. "But this was unique."

The prospect scared him.

"If this could be done, then it would endanger title to all of these minerals in that status."

He told his bosses at the BIA, "The stakes are high, because if this tract of Indian-owned minerals can be taken by adverse possession, then literally hundreds can be taken by adverse possession."

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Tribune special report: A Vanishing trust

Indians From page 1A

MANY Indians don't realize they are heirs to property. They often discover their ownership only after the BIA contacts them because someone is trying to buy or lease their land.

The Wolfes' suit, filed by attorney Earl Arnold, alleged James Wolfe had granted an oil and gas lease covering all mineral interests in December 1959. The suit, however, did not say to whom the lease was given.

"Actual drilling and production was obtained," the suit stated.

Wade was puzzled because neither the state Corporation Commission nor the federal Bureau of Land Management, two agencies that register oil and gas production, had records of activity on the land.

Wade wondered if the owners of the surface land had failed to report oil and gas production.

If a well had been drilled, it had been done without first gaining approval at a state court hearing. The Indians could sue over the failure to pay them royalties on their oil and gas.

Wade dug further. An acquaintance in the oil and gas business — someone Wade declines to name — told him there had been production on the property.

JOE PARKER, then Tahlequah BIA agency superintendent, sent a letter, which Wade had written, to the Oklahoma Tax Commission on May 19, 1984.

Parker and Wade were seeking information about oil and gas production on the property, including "unconfirmed reports" of drilling from early 1983 through May 1983.

"We are trying to recover royalty payments or compensation which has been their due since 1959," the letter said.

A week later, Parker and Wade wrote Raymond Sanford, the U.S. regional solicitor in Tulsa, that one of the Indian owners, John Blackwood, did not want to sign the proposed lease with Gis-Jim Corp., the name of the company created by the Wolfes.

Parker and Wade agreed with Blackwood, noting, "This matter (alleged illegal production) needs to be cleared up before a lease is executed. Our position is that this case needs to be litigated."

Further, the letter predicted the government would win the squatter's rights lawsuit on behalf of the Blackwoods and recommended that the regional solicitor take the case to court.

"We feel title to the said restricted mineral interest (owned by the Blackwoods) can be successfully defended," the letter said. "This case is of major significance to the Cherokee Nation," the letter continued, because many Cherokee Indians own mineral interests buried beneath non-Indian surface property.

YET, within two weeks, Wade was called to a meeting with Parker, Herren and Sanford. Also present was Abraham Zuny, then area director of the Muskogee BIA.

Wade explained his concerns, saying the BIA had a good case to pursue on behalf of the Blackwoods, and that "it shouldn't be any great task to pay these people what was due them."

But he was told at the meeting he had gone beyond the scope of his duties, Wade said.

Wade said he was ordered by Zuny to write to the Tax Commission to rescind the request for production information.

Further, Herren told Wade to make sure the Blackwoods signed the leases with the Wolfe family.

Wade did neither.

"It was a matter of ethics, morals, principle. I could not in good conscience, and I don't think any other BIA man in good conscience could have a client execute a lease where there at least had been production, and perhaps still was production."

IN AN abrupt turnaround after the meeting, Parker wrote a letter to John Blackwood on June 6, 1984, telling him that the BIA had changed its mind.

"It is my opinion that it would be to the advantage of the heirs to sign the lease," Parker wrote. Parker cancelled the request for tax commission records on drilling activity, Wade said.

Parker said his about-face in the matter was due to decisions by his superiors.

Wade was dumbfounded.

"Don't we have a responsibility to square up with these heirs?" he asked.

Herren increased the pressure to get the signatures of the five Blackwood heirs, Wade said.

"He (Herren) told me that he wanted them in and he wanted them in fast," Wade recalled.

But with Wade's refusal, Parker put the task to Pat Walls, Wade's colleague in the BIA realty office in Tahlequah. Rather than involve Walls in the dispute, Wade advised her to obey Parker.

"I did what I was told because he was the boss," Walls said.

HERREN was so adamant about the leases that he drove to Stilwell himself to get two of the signatures, those of Julia Blackwood and her daughter, Nancy. Julia spoke only Cherokee and Walls went along to translate.

Walls said Herren told her that if the Blackwoods lost their minerals in court by adverse possession, they would get nothing. But if they signed the leases, the Blackwoods would maintain their mineral rights and a share in the proceeds.

Wade and Walls said they never had seen a solicitor's office attorney take

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such an interest in securing an oil and gas lease.

John Blackwood, a forklift driver at an electric motor plant in Westville, said he held off signing for a while on Wade's advice.

But, said the 55-year-old Cherokee, the whole matter confused him. He never had seen the land that held the minerals he and the others inherited from Susie Chuwee Blackwood, a great-aunt.

When Walls showed up with the papers, he decided he better sign them. "I thought that was official and we had to get something settled." The others also signed.

U.S. DISTRICT Judge James O. Ellison in Tulsa said Herren and the U.S. Attorney's office presented him with the settlement of the issue, which he approved on Sept. 5, 1984.

By agreeing to the leases, BIA avoided the stickier issue of adverse possession, Ellison said.

The judge said he did not research the law in the matter because the attorneys had reached a satisfactory settlement. But, he added, "normally you would not feel that adverse possession could be asserted against an Indian allotment."

Solicitor Ralph Tarr, chief legal counsel for the interior department, said that although he is not familiar with all the facts in the case, in general adverse possession would be difficult to argue on Indian minerals.

Herren's insistence that the Indians would lose raised further questions because by all accounts, there was never any production on the land — the basis for the suit from which Herren backed away.

Landowner Wolfe said there are no wells on the land with the Indian minerals, although he owns wells on adjacent property that date back to the late 1940s.

Wolfe's attorney, Arnold, said there were other allegations in the lawsuit, chiefly that Susie Blackwood intended originally to grant mineral rights to the Wolfes.

However, Arnold said there were "enough allegations (of production) at one time for us to include that (in the lawsuit) . . . It was just an allegation."

HERREN said he too believed there was no production, but asked, "Why litigate the issue and run the chance of getting an adverse ruling? I don't understand that attitude at all.

"It's certainly not an issue I would want to try unless I absolutely had to."

The Bureau of Land Management raised the possibility that nearby wells were draining oil from the Blackwood property.

Parker said that because of recent questions about the case, the BIA plans to order a reservoir study to determine if drainage has occurred, and if so, how much money the Blackwoods might be due.

The Office of Inspector General investigated Herren. It came to the same conclusion as Herren — that the Indians would be better off signing the lease than risking a court loss.

The OIG report was completed July 31, concluding there was nothing "to indicate (Herren's) actions in the case were for any purpose other than the routine settlement of the suit to the benefit of the Blackwoods," the report stated.

IRONICALLY, after the push to have the Blackwoods sign the leases, the Wolfes never completed the process. The leases would have had to be approved in Tulsa County District Court.

"By the time we finally got the lease, the oil business had collapsed and we never did get to drill a well," Wolfe said.

Herren resigned in April, a month after a federal judge found him "grossly negligent" in the handling of another Indian lease case.

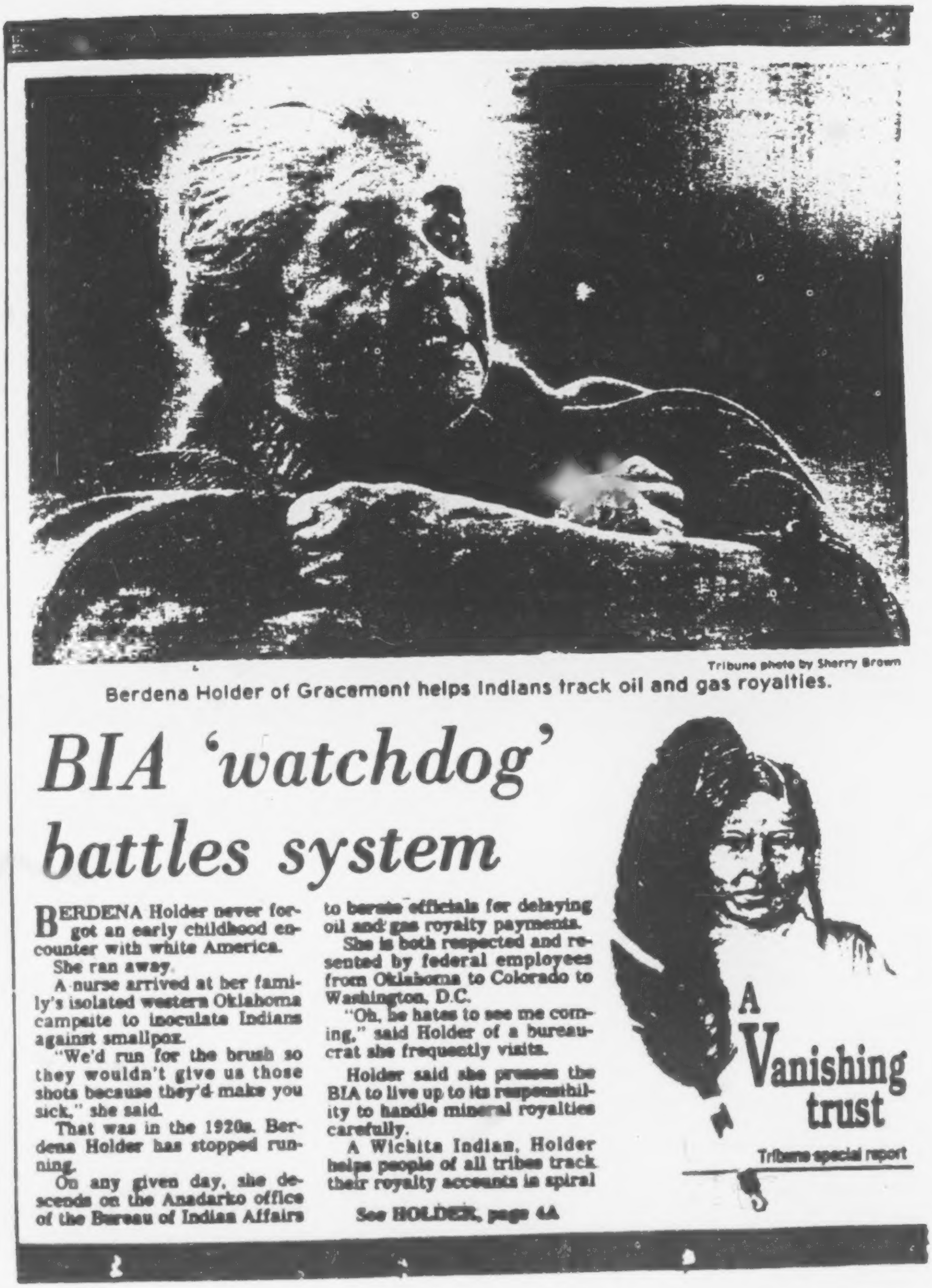
Herren, who has moved from Tulsa to Cordell, admitted to investigators that he had become too involved in the Blackwood lease. "It was a bad, bad posture to take," he said.

Rep. Sidney Yates, D-Ill., chairman of the House Appropriations Committee, promised a staff investigation, saying he has doubts about the quality of OIG's review.

"Overall, my impression is that it wasn't as thorough as I would like," Yates said.

Tarr said his staff is reviewing Herren's handling of the case.

"We are going to scrub the matter from one side to the other," he said.



Tribune photo by Sherry Brown

Berdena Holder of Gracemont helps Indians track oil and gas royalties.

BIA 'watchdog' battles system

BERDENA Holder never forgot an early childhood encounter with white America.

She ran away.

A nurse arrived at her family's isolated western Oklahoma campsite to inoculate Indians against smallpox.

"We'd run for the brush so they wouldn't give us those shots because they'd make you sick," she said.

That was in the 1920s. Berdena Holder has stopped running.

On any given day, she descends on the Anadarko office of the Bureau of Indian Affairs to berate officials for delaying oil and gas royalty payments.

She is both respected and resented by federal employees from Oklahoma to Colorado to Washington, D.C.

"Oh, he hates to see me coming," said Holder of a bureaucrat she frequently visits.

Holder said she presses the BIA to live up to its responsibility to handle mineral royalties carefully.

A Wichita Indian, Holder helps people of all tribes track their royalty accounts in spiral

See HOLDER, page 4A

A Vanishing trust

Tribune special report

Holder

From page 1A

notebooks she stacks in her bedroom.

Her "clients" are mostly elderly Indians confused by the system.

"As a result of our prying and digging, those monies some way, somehow find their way to the rightful owners," she said.

Physically imposing, Holder is stout, her iron-gray hair pulled back from her face.

A heart attack in 1979 and arthritis have put her in fragile health. She can't walk far and must take daily medication.

"When I get real tired, I quit and I rest."

And then she gets "fired up" again.

She alternately is abrasive and personable during meetings with government officials, one moment dressing down BIA officials like an army drill sergeant and the next minute teasing and joking.

AT THE mention of her name, bureaucrats roll their eyes.

"She has brought audit situations to our attention where we found more money was owed. There are also situations where she's gotten confused. I can certify that she is not always right," said William Bettenberg, head of the U.S. Minerals Management Service which audits royalty accounts.

Holder makes "a lot of noise," groaned Ross Swimmer, head of the BIA in Washington, D.C.

"She gets under our skin," admitted Joe Walker, acting area director of BIA's Anadarko office. "We don't necessarily think we are guilty of all the sins she places on us.

"But we may be guilty of some. So she is our conscience, our watchdog."

BORN in a tent in 1920, about four miles from the modest home near Gracemont north of Anadarko where she now lives, Holder spent her childhood in Indian camps with her family and tribe.

"All I could speak was Indian" as a young girl, she said.

"I had to learn English later as I went along, because I grew up with the old people. And that's all they ever spoke."

She married after World War II and, finding jobs scarce, moved with her husband, a mechanic, to Lawton in 1950.

For the next three decades, Holder raised her family while working as a laundry presser and restaurant cook.

Her husband died in 1968, and Holder returned to the Gracemont area in 1981 during the oil boom that swept the state.

Royalties from three wells she inherited from family members had jumped

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from several hundred dollars a month to about $3,500.

"I moved this way to watch and see what was going on, what was happening," she said.

BY 1983, Holder and other Indians began to receive royalty payments that were late or wrong. Sometimes they didn't get them at all.

"The older people said, 'There's something terribly wrong because our money's not right,' " Holder said.

"And when these people who have hardly any education come to that conclusion on their own, you have to know there's something to it."

Concerned about her own leases, Holder badgered BIA for months to order an audit. Eventually, she said, the government found that the leases, in which she owned shares, were underpaid about $20,000. Later, she received her portion, about $2,300.

In 1983, the government acknowledged an array of problems with its royalty accounting system.

In the fall of that year, the BIA held up all royalty payments for months while it installed computers designed to speed the process.

THE DELAY enraged and frightened Holder's neighbors and friends who counted on a regular flow of royalty checks.

"The monies had dropped so bad, people were losing cars and homes and just everything. It was just chaos," said Holder.

"In the meantime, there still were people coming to my house saying, 'What can we do, what shall we do?' "

Frances Wise, Holder's eldest child, said her mother first reacted in a personal way.

"I would come to see Mom, and there would be people I didn't even know who would be eating at our table.

Frances Wise

"One royalty owner getting paid means that a lot of people benefit. What little income there is is spread very widely to an extended family."

HOLDER'S next response was an echo of her own past. She decided to lead Indians in a mass "camp-in" on the grounds of the BIA's Anadarko office, complete with tents and outdoor cooking gear.

"Before we went, I talked to the people," said Holder.

She told them, "For our actions, we could go to jail. I want every one of you to understand that."

The demonstration stretched a full year, Holder said.

"We took turns. I'd go home for a couple days, then would come back."

Fortunately, Holder said, no one was arrested. But the demonstration attracted media attention and spawned two congressional hearings which documented the incompetence of the government's record-keeping. Major changes were ordered.

Holder said the results legitimized a threat she made to the BIA as the camp-in began.

She warned officials, "You know we've been peaceful. We've done things according to the laws you made. Now we're going to beat you with your own laws."

TODAY, Holder and other members of the Indian Mineral Owners Association, formed in the wake of the protest, are a steady presence at western Oklahoma's BIA offices.

Royalty payments still are erratic, the group maintains.

To her children, Holder passed on the desire to combat injustice.

As a leader of the American Indian Movement, Wise helped organize a demonstration for Indian rights in Washington, D.C., in 1972. Protesters occupied the BIA's headquarters for a week.

Wise has worked as a paralegal at a state legal service that represents Indians with grievances, and ran a drug awareness program for Indians.

Holder's son, Stanley, was involved in the American Indian Movement takeover of Wounded Knee, S.D., on the Pine Ridge Indian Reservation in 1973 in protest of government treatment of Indians.

More than 200 Sioux Indians had been massacred by U.S. troops at Wounded Knee in 1890.

Holder said she reared her family to be gentle and kind and right with God.

"But I also taught them you have to fight for what you think is right. And when you are right, there's no way that any one can put you down."

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Bungled royalties irk Indians

Stories by GRANT WILLIAMS, MARY HARGROVE and EDWARD M. EVELD
Tribune writers

TWO years ago, Oklahoma's Indians fought back. Their oil and gas royalty checks had been too small, too late, wrong or missing altogether, Indians told a turbulent congressional hearing in the spring of 1985.

For the elderly and unemployed counting on the money to buy food and other essentials, the faulty payments meant financial disaster.

Indians blamed their ca[illegible]aker, the Bureau of Indian Affairs.

BIA officials today a[illegible] they bungled the handling of royalties and [illegible]er money, especially during the energy boom of the late 1970s and early 1980s.

But that was yesterday, bureau officials claim.

The service now is greatly improved, they say, although BIA Director Ross Swimmer adds that problems are "a couple of years away from being really totally solved."

MANY Indians sharply disagree with BIA boasts that their royalties and other funds are handled better.

"We are being ripped off," asserts Berdena Holder, a Wichita Indian from Gracemont in Caddo County who helps Indians with their royalty paperwork.

> "We are being ripped off."
>
> — Berdena Holder

"It's still not working," says Juanita Learned, an official of the Cheyenne-Arapaho tribe in Concho in Canadian County.

Pat Ragsdale, Swimmer's assistant, warns the BIA cannot be a perfect guardian of Indian money.

"We've developed essentially a Band-Aid system," Ragsdale says.

"If they expect us to follow their lease from cradle to grave and tend to that as if it were our very own, we cannot do that. Not without a whole lot more money and whole lot more federal employees."

IN THE early 1980s, millions of dollars in royalties poured into the BIA office in Anadarko, center of an area where oil and gas were being produced in record amounts. More than $103 million went to western Oklahoma Indians from 1982 to 1986.

On one frantic day when energy companies vied for the right to drill on Indian land, an eager bidder plopped a helicopter onto the BIA's lawn in Anadarko, trying to get a jump on his competition. In 1982, bonuses to western Oklahoma Indians and tribes for signing leases soared to $122.6 million.

But in too many cases after the wells gushed in, royalty money never reached the Indians.

Grace Tallbird, an elderly member of the Cheyenne-Arapaho tribe, lost more than $60,000 in royalty payments when the BIA accidentally deposited her money in the wrong account. The owner of that account spent the money.

Bureau officials say they quickly reimbursed Tallbird for the full amount.

Yet, several Indian leaders claim the BIA initially decided to reimburse her gradually over several years, transferring royalties earned by the other person's leases to her.

"With all respect to the lady, considering her age and the amount of annual income of this (other) person, it is doubtful that she would have witnessed this recovery," tribal officials wrote a congressional subcommittee.

These Indians say Tallbird was reimbursed only after tribal leaders pressured top BIA officials.

TALLBIRD'S problems, and those of hundreds of others, stem from "one of the worst cases of mismanagement I've ever come across," says Rep. Mike Synar, D-2nd District, who chaired the April 1985 hearings.

"We have had a desperate situation out there," he says.

"We have had Indians who were foreclosed on, who were being thrown out of their houses (and) their cars repossessed" because the bureau did not do its job.

Nancy Childers investigated Indian problems during that period for the Oklahoma Corporation Commission.

"You hear the Indians complain and you think, 'Naw, it's not that bad,' " she says. "But it is. Their complaints are genuine."

The money is not a luxury for most Indians, says John Moore, chairman of the University of Oklahoma's anthropology department and Indian studies expert.

"It's really a hand-to-mouth existence for most Indian people," Moore says.

"What the lease money tends to go for is food. It's their bread and butter."

THE INDIAN unemployment rate in the Anadarko area is an estimated 38 percent, according to BIA statistics.

The U.S. Department of the Interior is charged by law with handling mineral rights for Indians through several agencies.

The BIA monitors the leasing of oil and gas lands for Indians.

A sister agency, Minerals Management Service, collects royalty monies from energy companies after wells are drilled.

The BIA then distributes the money.

Oklahoma has 51 percent of America's Indian-owned oil and gas lands. The accounts are handled in main offices at Muskogee and Anadarko and in 11 branches.

By law, the government must give Indians timely royalty payments, pay interest on money held too long in accounts and produce monthly explanations of payments.

AS CONGRESS fumed at the stories it was hearing in 1985 from Oklahoma Indians, scathing reports unveiled by federal investigators counted

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more BIA sins — this time with money accounts the bureau manages for Indians.

The Office of the Inspector General, an investigatory agency within the Interior Department, concluded the BIA had:

— Failed to supervise accounts of minors and adults who could not handle their own affairs, often approving "questionable" expenditures.

BIA's Anadarko office allowed the daughter of a 76-year-old resident of a nursing home spend restricted funds on a rifle, a 10-speed bicycle and camping equipment.

Approval was given, "even though her case file indicated the possibility that she was being manipulated by her daughter."

At the BIA Concho office north of El Reno, the parents of 9-year-old and 13-year-old boys were given $10,000 and $3,500 from the children's accounts for a down payment on a $20,400 van.

— Stacked up $450,000 in unclaimed accounts in the Anadarko office, making little or no effort at finding the owners.

Federal investigators searched for and immediately found 5 of 11 account-holders with large balances at the Anadarko office, including one who had written the agency a year before to identify himself and another owed $7,360 who had a relative working at the BIA.

Officials acknowledge that the quick discovery by investigators made them look bad, but insist that most searches would have been time consuming with little guarantee of success.

In addition, unclaimed monies which should have been transferred to the Treasury Department annually had not been sent out for about 10 years.

— Allowed dozens of Indian accounts in Anadarko to be overdrawn in sums ranging from 52 cents to $102,612 without aggressively seeking reimbursement.

"Overdrafts have been mostly ignored," the report concluded.

BIA's Swimmer admits the problems, but says their causes are understandable.

The energy boom forced an overburdened BIA staff to cope with large number of oil companies descending on Oklahoma.

"Gas and oil prices went through the ceiling," says Swimmer, "and everybody and his dog was out trying to find a lease anyplace they could."

"We went from nickel-and-dime stuff to multimillion-dollar deals," adds Joe Walker, acting area director of BIA's Anadarko office.

Swimmer says, "We were in a state of total confusion."

The boomtime disarray was heightened by the thousands of Indians who own property jointly and the BIA's antiquated manual method of dividing up appropriate shares of money.

A $5,000 royalty payment on one chunk of land could gum up the system, says BIA's Ragsdale, who served as head of the bureau's Anadarko office during the boom.

"We would have to match up that $5,000 with anywhere between 100 and 200 owners, divide it out, calculate it out and distribute it," says Ragsdale.

WHEN the BIA got behind in handing out the money, the Concho office "was so deluged with (Indian) people at their doorstep, they literally could not get the stuff processed without shutting down temporarily at certain times of the day," Ragsdale says.

Even with closed doors, work got so backed up that the Concho office was "like the black hole of Calcutta," according to Concho BIA official Scott McCorkle.

Today, new computers speed the division of royalty payments.

Royalty checks go out much faster and almost always to the right people, says Anadarko's Walker.

Regular reports on each lease are mailed, interest is paid and efforts are made to find people with unclaimed accounts, BIA employees say.

"I'm sure if the (inspectors) came back today, they would find some cases where we're not doing what we're supposed to do. But it's greatly improved," Walker says.

SINCE the critical 1985 reports, federal inspectors have made no major review of the BIA's handling of royalties and other monies to see if the system has improved.

And there are those who reject BIA claims of better service.

BIA actions are monitored by the Oklahoma Indian Mineral Owners Association, a group of royalty owners formed in western Oklahoma in the wake of the energy boom.

"For five years they've messed and fooled around with it" says the association's Holder. She claims late and wrong payments continue.

Holder says she and others pressure the BIA each month with telephone calls to ensure payments are made on time.

Rep. Glenn English, D-6th District, says he hesitates to acknowledge improvements in the bureau's performance.

"BIA is a perpetual problem that doesn't seem to end," he says.

"Comparing it with the service in the past, it may seem good, but I'm reluctant to say the problem is solved or that the service is good."

English adds, "It may be that there are so many Indian problems that BIA is incapable of handling the job.

"(But) I'm more inclined to think it's an attitude

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Anadarko BIA acting area director Joe Walker

Tribune photos by Sherry Brown

Concho BIA realty officer Randy Trickey

Concho BIA superintendent James Abeita

problem."

HOSTILE attitudes of BIA employees long have been an Indian allegation.

"They pop off to you something awful" when aid is requested, says Thelma Toehay Chapman, who has battled the government to collect her past-due royalty checks.

Childers says the BIA snubbed her inquiries from the Corporation Commission by not answering phone calls or letters.

"BIA was terribly callous toward these people," Childers says.

"I was getting the feeling they didn't care . . . that nobody in the BIA would lift a finger to help anybody."

OU's Moore says the bureau treats its clients poorly even though most BIA employees are Indians.

"Some of the very worst people, in terms of their attitudes toward Indians, are Indians."

These BIA employees have little knowledge of Indian culture and are more comfortable in the white world, Moore says.

"They're Indians by blood quantum only, who have very little sympathy with real Indians with real problems."

THESE charges are outrageous, counter BIA officials.

And, says James Abeita, superintendent of the BIA's Concho office, "Many of the people who work at the agency collect royalties themselves. So we have a vested interest in how well we do our job. And a source of pride in how well we do it."

Not all complaints against the BIA's Concho office are fair, says Randy Trickey, a realty officer.

"You are dealing with a people who traditionally have been economically deprived and dependent on government for certain services," says Trickey. "So I think there's frustration that they have to inflict on us."

It is depressing when Indians stalk from his office convinced he should do more, Trickey says.

"You feel like, 'God, I failed them.' "

Indians' intense anger seems to have abated in recent months.

"I don't think I've had anyone come in here in the past year and pound my desk," says Abeita. "They realize there's no need for that."

Many Indians never will give the bureau credit for improvements, Ragsdale argues.

"Indians love to hate the BIA."

But David Cox, an aide to Sen. David Boren, D-Okla., understands that distrust. The legacy of BIA incompetence is tragic for Indians who have tangled with government and lost.

"There is a whole generation of people out there who never saw basic justice."

Indian destinies shaped by oil

A
Vanishing
trust
Tribune special report

By GRANT WILLIAMS,
MARY HARGROVE
and EDWARD M. EVELD
Tribune writers

THE tale fires the imagination and a sense of poetic justice:

An Indian tribe, forced by the U.S. government to move from its homeland, years later discovers great pools of oil beneath the prairie grass and strikes it rich.

For the Osages who settled northwest of Tulsa 115 years ago, the fable became fact. The tribe retained the minerals and became known as the richest tribe in America.

Nature was not so kind to other Oklahoma Indians.

The Cherokees, forced to move here from the southeastern United States during the early 1800s over the "Trail of Tears," divided all their land among tribal members before oil strikes were made. Some fortunate Cherokees wound up with oil-rich property; most did not.

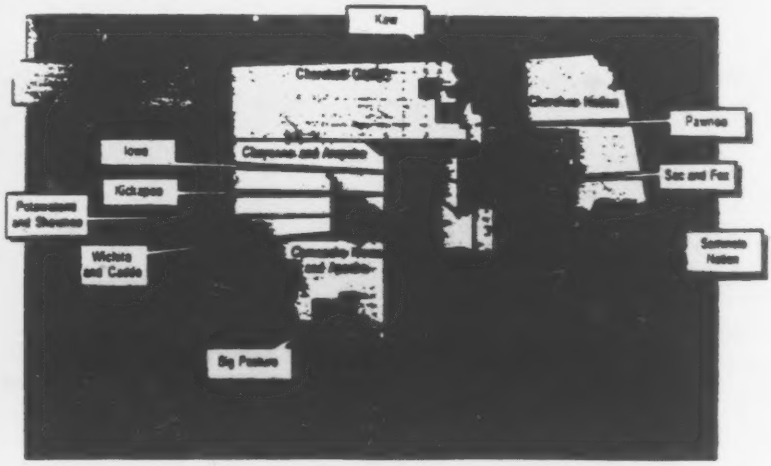
Oklahoma's 36 federally recognized tribes have different histories and destinies.

But oil is a common link and a mixed blessing.

Those with "black gold" ride on a roller-coaster of booms and busts, watching helplessly as world market prices determine what they receive.

Those who never had it, or saw production from their shallow pools decline sharply, today fend for themselves, launch businesses or take advantage of federal aid.

The Osage and Cherokee tribes followed different paths guided by foresight — and good fortune.


Kaw
Cherokee Outlet
Cherokee Nation
Pawnee
Iowa
Cheyenne and Arapaho
Sac and Fox
Kickapoo
Potawatomi and Shawnee
Wichita and Caddo
Comanche
and Apache
Seminole Nation
Big Pasture

Tribune photo by Sherry Brown

George E. Tallchief
. . . principal chief of the Osage Tribe.

The Osage Tribe:

A SINGLE decision made in 1906 secured a dazzling future for the Osages.

Tribal leaders chose wisely that year when, at their request, Congress approved the Osage Allotment Act.

The act provided for a tribal roll of 2,229 members, allocating about 640 acres of land to each.

The key: It gave individuals surface rights only.

Members communally retained rights to minerals beneath the ground of the Osage Nation, now Osage County. Income from production, called headrights, was shared equally by each tribesman on the original roll regardless of who owned surface rights. Money today is allocated by how many headrights — or fractions of a headright — an individual has.

In succeeding years, many Osages sold their land to non-Indians — tribal members now own fewer than 200,000 surface acres — but the mineral rights to 1.5 million acres remain intact.

THE 1906 act was unique in American Indian history. No other tribe retained its mineral interests like the Osages.

"It's been a great boon to our people," said George Tallchief, the tribe's principal chief.

"Our forefathers were very farsighted people to retain that mineral interest in community ownership," said Camille Pangburn, who recently retired from the Bureau of Indian Affairs in Pawhuska after 50 years.

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Indian

From page 1A

About 4,200 Osages, fewer than 130 of whom are original allottees, now receive royalties four times a year.

An oil boom in the 1920s brought each headright interest as much as $12,000 a year, according to BIA records.

"For that day and age, it was a tremendous amount of money," said Pangburn, the first woman member of the Osage Tribal Council, the governing body.

One of the best years for the tribe came in 1982 when total royalties from oil and gas climbed to $50.9 million, bureau records show.

With the collapse of the oil boom, royalties dropped by more than half to $22 million last year and to $12 million for the fiscal year which ended Sept. 30.

Osages pay 5 percent of their royalties to the state in gross production taxes.

THE TRIBE'S landmark decision in 1906 followed years of hardship.

In the early 1800s, the Osages lived in Missouri. Pressured by a land-hungry U.S. government, they ceded their property and moved to Kansas. After the Civil War, they again were urged to move on as their fertile farmland was coveted by white settlers.

With a $10 million settlement from the United States, the tribe bought a permanent home from the Cherokees on the grassy prairie of what now is Osage County. The tribe moved in 1872.

The Osages' new home was larger than either Rhode Island or Delaware, and today stretches west to east from Ponca City to Bartlesville; north to south from the Kansas border to the Arkansas River near Tulsa.

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OIL first was found in Osage country in 1897, but it was the discovery of the billion-dollar Burbank Field in 1920 that set off an explosion of national interest in the tribe.

Major American oil companies descended on Osage County, vying for leases in competitive bids at auctions held under the "Million-Dollar Elm" on tribal agency grounds in Pawhuska.

The decade's gushers brought Indians great wealth, and sometimes made them targets for unscrupulous whites.

Some whites married Indians — and then divorced them — to get at the money. One infamous "reign of terror" left several tribal members dead and whites benefiting from their deaths. Federal agents working undercover eventually cracked the case.

The government required that many Osages have legal guardians to manage their affairs. But too often the overseers bilked the Indians.

Many Osages had to seek BIA approval before buying necessities such as refrigerators and cars. The practice began to drop off in the 1930s when oil revenues declined.

"Those Indians who could manage their money got to buy whatever they wanted," said Pangburn. "But it was a safeguard for the ones who could not manage their funds or who were liable to be used by the non-Indians."

THE Depression signaled an end to the Osage boom time. Not until the 1950s when secondary recovery began, and again in the late 1970s when oil prices skyrocketed, did the tribe again see big money.

They were prepared.

While other Indians had watched as several much-criticized government agencies tracked their royalties, the Osages long ago arranged to work only with one — the BIA.

Osages paid for the operation of their local Pawhuska BIA agency until the late 1960s.

That office today has more professionals familiar with oil and gas than any other BIA office in America. It includes five petroleum engineers and two lawyers.

With one stop at the BIA office in Pawhuska, an oil or gas operator can obtain detailed data about the land and complete paperwork prior to drilling without worrying about title fees, abstracts or identifying multiple landowners.

"You don't have to go out and find every member who owns every fractional share of that land," said Tallchief.

"You just have to negotiate with one 'person,' and that's the tribe and agency.

MORE than 1.1 billion barrels of oil and 1.7 trillion cubic feet of gas have been produced in 12,700 oil wells and 800 gas wells since the first traces were found.

The tribe's relationship with the BIA has been notable for its harmony. But three years ago, scandal rocked the agency.

In 1984, a former administrative officer of the BIA's Osage Agency, Billy Joe Bigheart, pleaded guilty to embezzling $1,067.50 in Indian money accounts supervised by the bureau, according to federal records.

Bigheart had improperly loaned money from accounts to other Indians, then kept money intended as repayments, the records show.

In 1985, Interior Department inspectors issued a stern report on BIA operations.

"Deficient internal controls" and general mishandling of Indian accounts allowed the embezzlement to slip by, the report said.

FURTHER, inspectors said the bureau failed to:

—Distribute monies from estates of deceased Osages.

Federal inspectors discovered 18 accounts with balances exceeding $211,000. Those accounts had been open for an average of nearly 12 years with the oldest account on the books for 21 years.

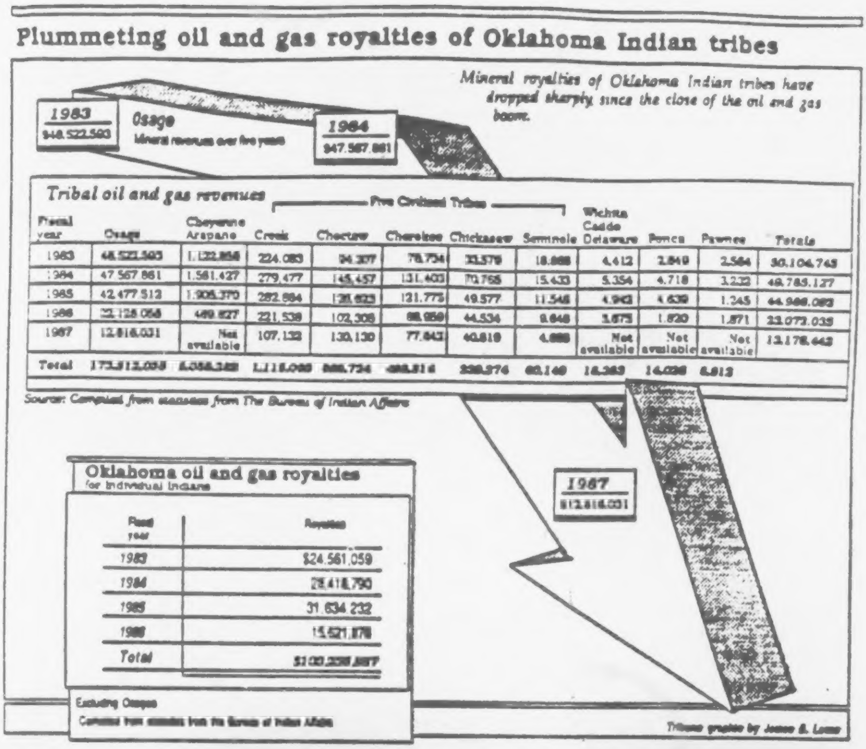
Investigators noted, "We feel that the superintendent has a moral obligation to distribute the funds ... No one outside of the agency knows of the existence of these estate accounts ..."

—Help Indians with their financial affairs.

In one case, an Osage man with an annual income in excess of $30,000 in headright money was evicted from his home. An alcoholic with many health problems, he was considered incapable of handling his financial affairs. Despite being under BIA supervision designed to help him with money matters, he couldn't make a $330 monthly rental payment on his house.

Jack Shoemate, head of the BIA's Osage Agency, maintains the critical report spurred major changes in his office.

Plummeting oil and gas royalties of Oklahoma Indian tribes



Mineral royalties of Oklahoma Indian tribes have dropped sharply since the close of the oil and gas boom.

Tribal oil and gas revenues

			Five Civilized Tribes								
Fiscal year	Osage	Cheyenne Arapaho	Creek	Choctaw	Cherokee	Chickasaw	Seminole	Wichita Caddo Delaware	Ponca	Pawnee	Totals
1983	48,522,593	1,122,856	224,083	94,307	78,734	33,579	18,888	4,412	2,849	2,564	50,104,745
1984	47,567,861	1,561,427	279,477	145,457	131,403	70,765	15,433	5,354	4,718	3,232	49,785,127
1985	42,477,512	1,905,370	282,884	139,623	121,775	49,577	11,548	4,943	4,639	1,245	44,988,083
1986	22,128,058	449,827	221,538	102,308	88,959	44,534	9,848	3,675	1,820	1,871	23,073,035
1987	12,816,031	Not available	107,132	130,130	77,843	40,819	4,888	Not available	Not available	Not available	13,178,443
Total	173,512,098	5,038,280	1,115,080	888,734	498,316	239,274	60,140	18,383	14,026	8,812	

Source: Compiled from statistics from The Bureau of Indian Affairs

Oklahoma oil and gas royalties
for individual Indians

Fiscal year	Royalties
1983	$24,561,059
1984	28,418,790
1985	31,634,232
1986	15,621,876
Total	$100,235,957

Excluding Osages

Compiled from statistics from the Bureau of Indian Affairs

Tribune graphic by James E. Lowe

Tribune photo by Sherry Brown

Camille Pangburn . . . Osage Tribal Council official

"It was glaringly apparent that I didn't have enough systems of checks and balances," Shoemate said.

"After that report came out, we got busy" overhauling office procedures. "Nothing has cropped up since that time."

Since 1981, the tribal council has employed its own auditor to monitor the BIA's accounting of Osage income.

OSAGES today view their future without illusion, Tallchief said.

The continuing oil bust has hurt.

"Not every Osage is wealthy," said Tallchief.

Shoemate said the highest quarterly headright payment was $10,000 in June 1981. The figure had slipped to $2,300 last June.

Federal housing assistance and job training programs ease the pain.

The tribe's own government launched a clothing manufacturing plant in Pawhuska and an industrial park in Hominy which have 140 employees.

The council budget, which amounts to $400,000 to $600,000 a year, is about ½ of 1 percent of the total royalties. It covers tribal and some BIA administrative costs.

Tallchief said he understands that the BIA, under director Ross Swimmer, encourages tribes to be more self-reliant.

"We realize that we need to diversify, we can't just rely on oil and government handouts — and that's what they are, you might as well admit it.

"But I think that we've become more diversified, standing on our own feet."

The Cherokee Nation:

FOR the Cherokee Nation, the century's oil and gas boom was a party it never attended.

The tribe arrived in what now is northeastern Oklahoma in 1838 and 1839 after its forced removal from Georgia, Tennessee and the Carolinas.

About 4,000 of 18,000 Cherokees who began the arduous trip died along the way.

In 1906, unlike the Osages, the Cherokees broke up their land under the allotment process by giving members both surface and mineral rights in 160-acre parcels.

The tribe allotted 4 million acres to its 41,000 members and sold the remaining 10 million acres to homesteading settlers.

"Oil and gas didn't figure into the economy of the Cherokee Nation" until the tribe obtained interest in Arkansas River bed leases in the 1970s, said Swimmer, chief of the tribe for a decade before joining the BIA.

"We were a landless tribe," he said.

THE splash of oil didn't miss individual Cherokees.

Some of the 41,000 tribal members found oil, mostly in Sequoyah County.

But the 1906 federal agreement left the tribe without property or income.

"It was actually called the act winding up the affairs of the Five Civilized Tribes," Swimmer said.

"It was as close to a termination act as you could get."

The tribe clung to existence for years.

William W. Keeler, chief of the Cherokees from 1949 to 1975, kept the tribe alive with money raised from private sources, Swimmer said.

Keeler was president and chief executive officer of Phillips Petroleum Co. from 1968 to 1973.

Keeler launched a non-profit historical society and a foundation that aided Cherokee people. With $2 million from a federal land court judgment, the tribe built an office building and a restaurant-gift shop complex near Tahlequah in 1960, Swimmer said.

Not until the 1970s when federal programs were targeted for organized Indians did the tribe have a chance for a large-scale regeneration, Swimmer said.

"The government needed (legal) entities to put the money in," he said.

ADOPT an official constitution, the government suggested, and money will flow.

"We said, 'Fine, the Cherokee Nation survives on paper, we'll make it a real thing,' " Swimmer said.

"And we became a grant recipient for federal funds."

The tribe's constitution was adopted in 1976, the year after Swimmer became chief.

His principal goal: use of federal funds to build an economic base for the future of the tribe, the nation's second-largest with 78,000 members.

During Swimmer's administration, the Cherokees obtained unused federal land in Delaware County and worked to develop the economy of the 14 counties where most Oklahoma tribal members live.

"Every time I could get my hands on a federal grant, we'd try to turn it into a building or a road," Swimmer said.

TODAY, the tribe employs more than 1,000 people in operations that include the Cherokee Nation Industries electronics assembly company, a horticulture center, a motel-restaurant complex, cattle ranching and woodcutting businesses, arts and crafts stores, a home health care agency, an apartment complex and a utility firm.

Larry Wise
... executive director
Cherokee Nation

Federal employment training programs put another 300 Cherokees to work.

Oil and gas royalty income, less than $100,000 a year, has little impact on the tribe's budget which tops $45 million yearly, said Larry Wise, executive director of the nation.

"We've been able to weather the storm (of crashing oil prices), primarily because we weren't in it and weren't dependent on oil and gas," Wise said.

"But I wish we had more oil and gas revenues to further industrial development in other areas.

"The Cherokee Nation is not rich," he said. "We don't even have an industrial development fund that we can tap into. We'd like to try to develop that as we grow and profit."

The tribe is acutely aware that federal funds may dry up in future years, Wise said.

"That's why we have to bootstrap ourselves."

TULSA TRIBUNE
18 Nov 87

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BIA chief's message sparks Indian debate

By MARY HARGROVE,
GRANT WILLIAMS
and EDWARD M. EVELD
Tribune writers

WHEN Ross Swimmer talks, Indian Country listens.

And then it answers with a fist-clenching, screaming, get-the-bum-out-of-there crescendo.

The debate? Should the government ease out of the lives of the Indians or does its historic obligation extend forever?

It has been nearly two years since Swimmer, former Cherokee principal chief from Tahlequah, took over as head of the Bureau of Indian Affairs — one of the largest, oldest and most controversial of federal agencies.

He oversees a $1 billion budget with responsibility for 1.4 million American Indians, Eskimos and Aleuts.

There are 53 million acres in trust and 250,000 individual Indian accounts to manage, not to mention more than 308 federally recognized tribes in the contiguous 48 states and another 250 Alaskan native village groups, each with a different treaty and governmental structure.

SWIMMER HAS placed the 163-year-old agency at a painful crossroads.

The 44-year-old Oklahoman envisions a new Indian. He preaches his message with the fervor of a tent-revival minister.

"I look at the BIA as an 18th or 19th century agency dealing with 21st century problems," he explained.

"We do an average job. In some areas we do very well. In some we don't do well at all.

"I think the Bureau of Indian Affairs should look at going out of business. I think there should be a planned time when the BIA can reduce the impact that it has in Indian Country.

"I would free the Indians. It's time to free the Indians from the constraints they face

See SWIMMER, page 4A

A
Vanishing
trust
Tribune special report

Tribune photo by Dick Grant

Ross Swimmer, BIA head, discusses history and the future of Indians.

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Tribune special report: A Vanishing trust

Swimmer

From page 1A

now, from the paternalistic attitudes of the federal government."

Swimmer proposes a 10-year transition period in which tribes can be trained to manage their own businesses, reducing the BIA role to adviser.

"What federal aid has done is perpetuate the isolation of Indians from the rest of society and keep them in poverty."

Now, tribal decisions on contracts are reviewed and approved by the BIA in most instances.

"We don't allow them to make mistakes; we indemnify them. We tell them 'Anything that you screw up out there, you just come see us, sue us, we're responsible.'

"Under that scenario, we can't win. And I contend they can't either."

THE RESPONSE is swift and fierce.

"His position is one of the most radical we have seen in this century and it is the most confrontational," declared Suzan Harjo, executive director of the National Congress of American Indians, largest of Indian organizations.

"It's to the credit of Indian people that we haven't matched him outrage for outrage.

"He is not advocating that people be killed outright but that it be slow death, because the policy he describes is termination in its purest sense and in its vilest sense."

Members of Harjo's organization jokingly have dubbed Swimmer "Ross The Knife," but no one is laughing when they call for his ouster, something they have done four times.

Individual tribes also publicly discredit him.

IN FEBRUARY, The United Indian Nations of Oklahoma asked that he be removed, citing his "failure to act on behalf of Oklahoma tribes."

A month later, seven Inland Empire Tribes walked out of a meeting at the BIA Portland, Ore., office protesting proposals which included turning over BIA schools to states or third parties.

Oklahoma Indians reacted angrily in May to a draft paper Swimmer presented to an Indian sovereignty committee appointed by Gov. Henry Bellmon. The members were going to discuss state vs. tribal duties including taxation rights.

Swimmer sent what he thought would be a draft — not a formal proposal — to kick off discussion. The paper suggested, among other things, allowing the state to tax Indian bingo.

"Quite simply, that was the dumbest piece of paper I've ever seen as far as trying to stimulate economic development in Oklahoma," said Truman Carter, treasurer of the Sac and Fox Nation.

Swimmer sighed disgustedly over the backlash.

"It apparently took on the aura of being the governor's and Ross Swimmer's answer to the problems of Indian Country and it was never, never intended to be," he said.

SWIMMER is irritated at the continuing protest over his plans and over the tirades against President Reagan's push to make Indians self-supporting.

"Everybody is paranoid thinking that this administration is being real mean to Indians. Nothing could be further from the truth."

Swimmer's beat-back-the-bureaucracy blueprint closely parallels an analysis prepared for Reagan in 1984.

Swimmer was an author of the 133-page report, an indictment of the BIA's "paternalistic control" that "thrives on the failure of Indian tribes."

The BIA was established in 1824 as a part of the War Department. It has been a part of the U.S. Department of the Interior since that department was created in 1849.

Nearly 2,000 barriers to economic development were identified in the presidential commission analysis, laying the blame for 30 percent of those problems on BIA.

THE REPORT pointed to under-qualified employees making major decisions for tribes, turf fights among agencies serving Indians, six years of ignoring General Accounting Office findings on incompetent management of a multibillion-dollar trust fund.

"What the BIA accomplishes is not minimizing mistakes, but rather it causes the mistakes to cost more and at the same time prevents a healthy, private, sector from taking root," the report concluded.

When Swimmer took over as assistant secretary for Indian affairs, he was handed that same report and told to enforce it.

He was ideal to champion the free enterprise philosophy.

SWIMMER, born in Oklahoma City, is one-fourth Cherokee. He received a bachelor's degree in political science and a law degree from the University of Oklahoma.

He was president of First National Bank of Tahlequah for the 10 years he served as principal chief of the Cherokee Nation.

During his tenure, he developed a tribal government with corporate strength. Assets grew from $9 million to $34 million as the tribe developed a variety of companies including an electronics assembly firm and a motel-restaurant complex.

Swimmer's actions are viewed by critics as a return to a 1950s federal policy called termination under which federal dollars and recognition of tribes were withdrawn.

Between 1954 and 1962, 109 Indian tribes ceased to exist, in the guise of making Indians equal citizens. It is a policy now widely recognized as a mistake. Indians never have forgotten those fearful days.

"Of course what Ross is doing is termination," Harjo said. "These programs are part of the entitlement for which we gave up a territory to the United States and its citizenry.

"These are contractual obligations. The United States owes us these things. It is a debt of contract. If we want to re-examine the deal, we'll have to start with acre for program and I'd be most happy to do that."

SWIMMER fends off rebukes by Indians that trimming back BIA support violates treaties in which the government promised a trust responsibility in exchange for land.

"If there was a debt created, when does it get paid? Legally, the debt is paid. In most cases, legally, it has been paid.

"I just don't see how we can continue to beat ourselves over the head with the treaties and say there is something in there that hasn't been resolved.

"I think it would have ended a long time ago but there is a desire on the part of Congress and the public to maintain this Indian presence.

"There seems to be a perception that Indian people they see at powwows are real and they should remain almost preserved so they can be visited and seen in their native culture.

"And that doesn't exist anymore out there," he said.

"To say it's a forever deal, I don't think it is."

Series at a glance

☐ NOV. 9:	Austin Walker -- A case of the wrong man
☐ NOV. 10:	The System
☐ NOV. 11:	Battles in Court
☐ THURSDAY:	The Bureau of Indian Affairs in Oklahoma
☐ FRIDAY:	The Money Watchdogs
☐ MONDAY:	Disputes over the Land
☐ TUESDAY:	The Osages and the Cherokees
■ WEDNESDAY:	Ross Swimmer – The future BIA

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Swimmer is sending the signal that the change from bureaucracy to business is inevitable and those who delay jeopardize their future.

WHY start the painful separation now?

"If we don't, they never will. And that's the most difficult part of this whole process. How do you turn it over to the tribes gradually?

"In a lot of tribes, the people on that reservation are scared to death to let a tribal leader take control of that money," he said, "because they just know that the brother-in-law is going to get the first shot at it, the local banker where I just bought my Cadillac is going to get the next shot and then pretty soon there's nothing left.

"We have two tribes right now, a little one and a big one, that are literally shut down because they haven't been able to manage their books.

"It's legitimate fear. Unfortunately, there are not a lot of skills like that in Indian Country."

Charles Mankin, head of the Oklahoma Geological Survey, a state agency created to promote effective use of natural resources, believes the thrust toward separating Indians from the BIA will incur large risks.

"For some tribes you can do it with some ease. With others, it would be a disaster. I don't think there is any question that it's a complicated issue."

ONE OF Swimmer's first moves toward reducing BIA's role involved education — a red flag topic.

"I would like to see BIA get out of Indian education," Swimmer said. "I would rather it be handled directly by the tribes or by the public school system. We would wind up turning our facilities over to them along with rehab money and operating money. We fully intend to fund the schools at no less than what we are now."

Rep. Ben Nighthorse Campbell, D-Colo., is the only Indian in Congress. He is skeptical about Swimmer's cutting back on programs, particularly education, and decries it as an unworkable, quick fix to decades of problems.

"What Ross wants to do is literally yank the existing programs out from under the tribes without anything to take up the slack," he said.

"I view that like taking your son to the lake and trying to teach him to swim by throwing him in. Some will swim but a hell of a bunch of them are gonna drown. It's the same with the Indians."

CAMPBELL, a member of the House Interior Committee which has oversight on BIA programs, cites an attempt earlier this year to shut down the Phoenix (Ariz.) Indian School.

"He (Swimmer) was going to ship 400 kids like cattle off to a California boarding school. Our committee got so damn mad we issued a moratorium so they can't close it for a year until we get a better picture of what is going to happen to those youngsters."

Swimmer said he was acting on a congressional mandate which ordered the closing of the school.

"On my own initiative, I said I would not close the school until I saw if this was good for those kids."

An analysis showing $5 million in repairs would be needed to keep the Phoenix school open, combined with a minimal enrollment, convinced him the facility was not needed.

"It became a political football for people like Ben who were playing politics. They were claiming they were friends of the Indian and they were going to stop this monster from going out there and closing this wonderful school."

HARJO, originally from Oklahoma, proposes a 10-year moratorium on new programs as a time to examine the decades of give-and-take-away legislation.

"We are always on the edge of chaos or disaster so the most immediate things are being dealt with, and it's wearing everyone out. There is very little time for long-range plans," she said.

"We need a period where everything stops for a while so we can assess how the programs are working."

Harjo said too often Indians are forced into a position of defending a marginal federal program because "it is the only thing out there and if we don't preserve it, we might have nothing."

That won't work, Swimmer responded. "Time marches on" and Indians need to move ahead, not stall for a few years.

TO ADD to the confusion, Congress has sent mixed messages to Indians with its failure to adopt a consistent attitude about them, Swimmer said.

"Congress should come in for its share of the blame because nobody has really decided what the mission of the BIA is," he said.

"On one hand I'm told we want you to turn everything over to the tribes and then when they screw up, they blame us for not going in and stopping it. That is the essence of Catch-22.

"You're whipsawed back and forth. One day you're a trustee, the next day you're not.

"I can't see people continuing in some of the misery they are in because we're afraid to move. I've seen with the Cherokees what we can do to make a difference.

"But I just can't seem to get through."

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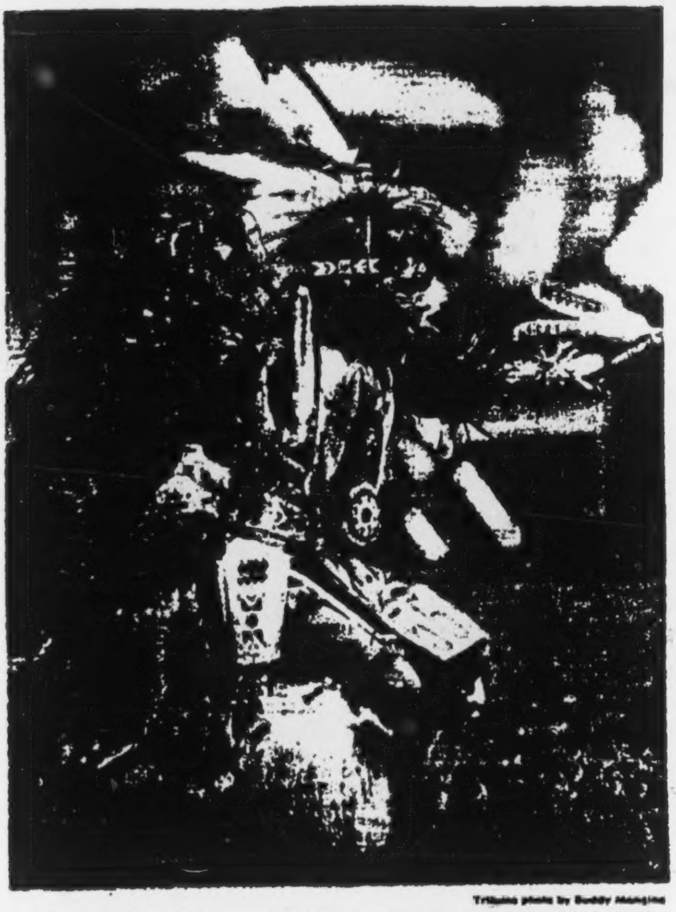

Tribune photo by Buddy Mangine

Nicholas Wah Pe Pah, 6, of the Winnebago Tribe, was one of hundreds of Indians participating in Tulsa Powwow in Mohawk Park this summer.

Senator MELCHER. We all have questions other than those I have asked you orally today to submit to you, and I hope you will be able to respond to them.

Mr. Robison, we sent you some questions last week. Do you know when we could expect some response to those?

Mr. LAWTON. We are completing those right now, and we would like to get them to you by the end of the week if possible.

Senator MELCHER. All right. Thank you.

Now, let me give you one paragraph out of David Linowes' letter of May 12. I put this whole letter in the record, but I just want to emphasize this one paragraph.

"It appears that although there has been some action since that time", and that was since the report was submitted by the Linowes Commission to the President and to Congress in January of 1982, "since that time, in implementing our recommendations progress seems to have been quite slow. This is surprising, as all of our recommendations were accepted by the administration over six years ago when I presented the report to the Secretary of the Interior and the President. I especially note that internal control procedures still need attention."

So let me just state rather candidly that throwing figures around in the billions of dollars is not my idea of anything that has ever been documented, and we should resolve in public hearings just what the facts are.

That is why we are engaged in this series of hearings, to establish the best facts that are available and then review them because this committee feels very responsible for this whole program in which all three of you were involved: Mr. Richards because he is the Inspector General; and Mr. Robison because he has the first responsibility of inspections; and Mr. Bettenberg because he has the responsibility of managing and auditing the royalties.

So I would like to announce to you that I made a request of the General Accounting Office to do a study of BLM's inspection and enforcement program.

I am also asking OTA to analyze the MMS computer system.

The letters requesting that are dated May 20 in the case of the Office of Technology Assessment and May 13 in the case of the Comptroller General. We do that not to create dispute. We are doing that to establish the truth based on credible information. We want to get at the truth, but I think we are going to have to be working together for some time.

I think we will establish the best set data possible on this whole subject during this summer.

I would invite you to critique us as a committee in what we are doing, and I also invite you to give us any further thoughts that you might have, and if you would answer these additional questions, we would very much appreciate it.

These two letters to the General Accounting Office and to the Office of Technology Assessment will be made part of the record.

[The letters follow:]

J. BENNETT JOHNSTON LOUISIANA CHAIRMAN

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United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON DC 20510-6150

May 13, 1988

The Honorable Charles A. Bowsher
Comptroller General
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Bowsher:

As you know, the Department of the Interior's Royalty Management program is second only to the income tax as a revenue source for the federal government. In fiscal year 1987 alone, this program was responsible for the collection and distribution of approximately $5.6 billion of mineral revenues.

However, persistent allegations of significant problems in the management and operation of the program continue. I had hoped that our efforts in securing passage of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA) would remedy this situation. However, it appears that there has been a failure by the Department of the Interior to implement adequately aspects of this law.

One area of particular concern to me is production verification. It is essential that the federal government receive royalties based on accurate production information. This is crucial to the states as well, since they receive a 50% share of the onshore royalty collections.

The Bureau of Land Management is responsible for the inspection of the some 21,000 onshore Federal and Indian leases to verify production. I am therefore requesting the GAO to undertake an investigation of the BLM's inspection and enforcement program. This study should include evaluation of the following:

1. A description of the existing production verification component of the inspection and enforcement program;

2. For the states which generate the greatest royalties from oil and gas production, the number of production verification inspections for 1986, 1987 and 1988, and the nature of the inspections;

3. The number of instances of noncompliance issued in each such state during 1986, 1987 and 1988, due to problems in production verification and the nature of violation cited;

4. The number of leases on which civil penalties were collected under FOGRMA during 1986, 1987 and 1988, nature of the violations, and the amount of such penalties;

5. The number of leases on which conduct resulted in criminal penalties during 1986, 1987 and 1988, the nature of the conduct, and the nature of the criminal penalty;

6. An evaluation of the priorities used by BLM to determine which leases to inspect for production verification purposes, including whether the standards used to set the priorities are reasonable;

7. Whether BLM is adhering to these standards;

8. An evaluation of the adequacy of production verification inspections performed by BLM;

9. An evaluation and analysis of the record of cooperation between BLM and MMS in their royalty management efforts;

10. Whether BLM or MMS is better able to fulfill production verification responsibilities; and

11. An evaluation of whether BLM's inspection and enforcement program is fulfilling the requirements of FOGRMA.

I have scheduled oversight hearings on the royalty management program for May 23, 1988, and may wish to conduct further hearings focusing on the BLM inspection and enforcement program in July or August. For this reason, I request that you provide a response to the information requested in points 1 through 6 above no later than July 11, 1988.

We would be pleased to discuss this investigation further with your staff. Please contact Patricia Beneke (224-2383) or Lisa Vehmas (224-7555), staff members of the Subcommittee on Mineral Resources Development and Production, if you have any questions regarding this study.

Sincerely,

John Melcher

John Melcher
Chairman, Subcommittee
on Mineral Resources
Development and Production

JM/pjb

J. BENNETT JOHNSTON LOUISIANA CHAIRMAN

DALE BUMPERS ARKANSAS
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GARY G ELLSWORTH CHIEF COUNSEL FOR THE MINORITY

United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON DC 20510-6150

May 20, 1988

Dr. John H. Gibbons
Director
Office Technology Assessment
U.S. Congress
Washington, D.C. 20510-8025

Dear Dr. Gibbons:

Mineral royalty receipts are second only to the income tax as a revenue source for the Federal government. In fiscal year 1987 alone, the Department of the Interior's Royalty Management Program was responsible for the collection and disbursement of approximately $5.6 billion in mineral revenues. Yet, due to technical problems with the data about oil and gas and other mineral leases and with the automated systems used to process those data, collection of mineral royalties has fallen short of its full potential.

In this era of fiscal constraint, it is crucial that the technologies used in the management of Federal mineral royalties be efficient and effective. We are therefore writing to request that the Office of Technology Assessment undertake a study of the technological opportunities for improving the collection of royalties under the Federal Oil and Gas Royalty Management Act. We anticipate that this study would draw on previous OTA work on oil and gas and coal leasing.

We would be pleased to discuss this study further with your staff. Please contact Patricia Beneke (224-2383) or Lisa Vehmas (224-7555), staff members of the Committee on Energy and Natural Resources, if you have any questions regarding this study.

Sincerely,

J. Bennett Johnston
Chairman

John Melcher
Chairman, Subcommittee on Mineral
Resources Development and
Production

JBJ/pjb

Senator **Melcher**. Thank you all very much. The subcommittee is adjourned.

[Whereupon, at 12:12 p.m. the hearing was adjourned.]

APPENDIX

RESPONSES TO ADDITIONAL COMMITTEE QUESTIONS

United States Department of the Interior
OFFICE OF INSPECTOR GENERAL
WASHINGTON, D.C. 20240

JUN - 3 1988

Honorable John Melcher
Chairman, Subcommittee on Mineral
Resources Development and Production
Committee on Energy and Natural Resources
United States Senate
SH-730 Hart Senate Office Building
Washington, D.C. 20510-2601

Dear Mr. Chairman:

This is in response to the Subcommittee's request of May 24, 1988, for additional information related to the May 23, 1988, oversight hearing on the Royalty Management Program. Specifically, our answers to the 12 questions raised by the Subcommittee are attached.

Our answers are based on previously issued audit reports, management responses to the reports, and recent discussions with Departmental officials to update corrective actions taken. We have not conducted any recent field inspections to verify actual implementation of corrective actions stated to have been taken by the Minerals Management Service and the Bureau of Land Management. We plan to verify whether these corrective actions were accomplished as part of our next biennial audit of the Royalty Management Program. The next biennial audit report is planned to be issued in April 1990.

If you or your staff have any questions concerning these matters, please contact Deputy Inspector General Joyce N. Fleischman at (202) 343-5745.

Sincerely,

James R. Richards

James R. Richards
Inspector General

Attachment

OFFICE OF INSPECTOR GENERAL ANSWERS TO ADDITIONAL QUESTIONS REGARDING MAY 23, 1988, ROYALTY MANAGEMENT HEARING

Question 1. Your audit reports point out many problems with the current royalty management system. Which, in your view, are the most serious of these problems?

o What steps should the Department of the Interior take to resolve these problems?

Answer. Our April 1988 biennial report summarized 17 audit reports on various aspects of the Royalty Management System. The most serious problems addressed in these reports and associated corrective recommendations were the following:

- The Minerals Management Service had not provided adequate audit coverage of royalties being collected. Too much emphasis was placed on audits of refund requests and reconciliations, while insufficient audit resources were allocated to comprehensive audits of leases. In our report on the Service's Royalty Compliance Division, we recommended that the Service (1) compile a lease inventory, (2) develop a 6-year audit plan that includes auditing revenues collected as far back as fiscal year 1982 before the records are no longer available, (3) minimize audit work on refund requests and reconciliations while maximizing comprehensive audits of leases, and (4) distribute audit resources based on work load requirements. The Service agreed and has taken actions to implement the recommendations.

- Product valuation regulations and guidelines for oil and gas were not finalized in a timely manner. As a result, we found that the Service expended considerable resources ($1.1 million annually) resolving "standard issues" that could have been routinely handled by industry if guidelines had been issued. These issues were discussed in our report on the Service's Valuation and Standards Division. We recommended that the Service (1) expedite the publication of final regulations and guidelines and (2) review Division personnel requirements and retain only those employees required to maintain regulations and respond to questions on regulatory and policy issues. The Service agreed with the two recommendations. Final oil and gas regulations were published on January 15, 1988, with an effective date of March 1, 1988. Coal regulations will not be finalized until the end of fiscal year 1988.

- The Government may forfeit royalties of $79 million over the next 3 years because the Bureau of Land Management did not have the authority to allow the economic recovery of small coal deposits that exist adjacent to present coal lease boundaries. Also, noncompliance with requirements for continued mining operations resulted in a $3 million loss in advanced royalty payments and penalties. These findings were discussed in our report on the Bureau's Federal coal management program. We recommended that the Bureau obtain legal advice to determine what immediate actions could be taken to mining coal adjacent to lease boundaries and pursue obtaining any statutory changes deemed necessary. The Bureau concurred and proposed legislation to authorize the extending of lease boundaries.

- We reviewed 42 coal leases with terms (mainly royalty rates) that were required to be periodically readjusted and found that $38.5 million of royalty and rental income due the Government was not being collected on a timely basis. In addition, the amounts due the Government were not fully protected, as only $4.5 million of the $38.5 million due was secured by posted bonds. These findings were reported in our report on the Bureau's coal lease readjustments. The report included 16 recommendations to streamline and expedite the appeals process and ensure adequate bond coverage. The responses to the report were adequate to resolve all 16 recommendations.

- Drainage protection was not given sufficient priority among the Bureau's work load responsibilities. Also, deficiencies were noted in the expertise of the drainage staff, program guidance, case documentation, and case tracking. Consequently, the Government and some Indian tribes could lose about $6.4 million of royalties for oil and gas that drained to adjacent non-Federal leases. Drainage problems were reported in our report on the Bureau's Drainage Protection Program. We recommended that the Bureau (1) increase the priority of the Program, including committing sufficient financial and personal resources; (2) clarify Program guidance; and (3) provide more technical training to Program personnel. The Bureau concurred and is in the process of implementing the recommendations.

- The Bureau did not adequately support the oil and gas Inspection and Enforcement Program. Consequently, fewer inspections were performed than planned, the number of inspectors was below authorized levels, and inspectors were assigned duties that were not related to the Program. As a result, the Bureau could not ensure accountability over oil and gas produced and sold from Federal and Indian lands. These problems were discussed in our report on the Bureau's Inspection and Enforcement Program. Audit recommendations were made to (1) increase the number of inspectors to authorized levels, (2) emphasize oil and gas production and sales volumes, and (3) provide training to the inspectors. The response from the Bureau was adequate to resolve all 17 recommendations. The most significant Bureau action in process was the revision of its inspection and enforcement strategy document to (1) specify frequency of inspection requirements and (2) address verification of production and sales volumes.

Question 2. I played an active role in the drafting and passage of the Federal Oil and Gas Royalty Management Act, and have a strong and continuing interest in making certain that this legislation is properly implemented. Do you believe that the requirements of FOGRMA are being fulfilled?

- What about the requirement that lease sites with significant oil and gas production be inspected annually?
- What about the requirement that oil and gas lease accounts be audited and reconciled?
- What about the requirement that royalty receipts be disbursed to the States, Tribes, and Indian allottees in a timely fashion?

Answer. Production inspection requirements for onshore leases were not being fulfilled during fiscal year 1985, the period covered by our audit report of the Bureau's Inspection and Enforcement Program. However, Bureau responses to the report and subsequent discussions with Bureau headquarters personnel indicate that the Act's inspection requirements are now being accomplished.

We also reported that prior to fiscal year 1988, auditing requirements were not being effectively accomplished. Our review of five resident audit offices showed that these offices had comprehensively audited less than 2 percent of the lease universe in fiscal years 1986 and 1987. The low rate of comprehensive audits resulted because substantial audit resources were expended in auditing claims for refunds by companies which apparently made royalty overpayments on Federal and Indian leases. However, this situation should substantially improve if Minerals Management Service fully implements its recently completed audit strategy and fiscal year 1988 audit plan.

The Service has basically completed the reconciliation process for the old automated Royalty Accounting System. Concerning the new Automated Financial System, our Fiscal Accounting Division report noted that 1,300 of 2,000 payors were not reconciled. However, we believe that the Service is now attempting to comply with reconciliation requirements and is making every effort toward timely distribution of royalties to states, tribes, and Indian allottees.

Question 3. I am very concerned about the adequacy of MMS's audit efforts. Your report states that "the Royalty Compliance Division was not providing adequate audit coverage of the mineral lease universe." You also discovered that the resident audit staff had comprehensively audited less than 2 percent of the lease universe in fiscal years 1986 and 1987.

- o Can you briefly describe for us the existing MMS audit program?
- o Does the existing MMS audit program comply with the Linowes Commission recommendations in the area of auditing?

Answer. The Minerals Management Service audit program that existed prior to fiscal year 1988 was not suitable for providing adequate audit coverage of the lease universe or for effective use of the Service's audit resources. We concluded that the Service's audit resources were more often directed toward auditing special referrals from the Bureau of Indian Affairs and Bureau of Land Management and refund requests from payors rather than by an existing audit plan for comprehensive audits. Also, previous annual audit plans that did exist were very general and brief and largely allocated audit resources to broad functional areas such as account reconciliations, lease audits, and litigation support. The previous plans did not list the companies or leases scheduled for audit. In summary, we concluded that almost all the audit resources were devoted to nondiscretionary functions rather than the comprehensive audit coverage of leases.

The Linowes Commission recommended that a definitive plan be developed for choosing which companies should be audited. The Commission recommended that the plan ensure adequate audit coverage of small companies and onshore leases including Indian leases. In our opinion, the Service did not fully comply with these recommendations prior to fiscal year 1988 because a structured audit plan was neither developed nor followed by the Service. As previously mentioned, the Service did not have a plan to provide adequate audit coverage but rather had outside entities direct most of its work load.

Subsequent to completion of our audits, the Service has developed an audit plan, which we believe is a major step forward in accomplishing the Linowes Commission recommendation.

Question 4. Are you familiar with MMS's "audit strategy"?

o Do you think that the existing strategy is adequate?

Answer. The April 1988 audit strategy is only adequate when combined with the fiscal year 1988 audit workplan that was issued in May 1988. Although significant progress has been made in the Minerals Management Service audit planning process, the following issues and improvements need to be addressed to increase the adequacy of the strategy as follows:

- The strategy still provides for 40 percent nondiscretionary work at the residencies, a practice which has been criticized in our last two audit reports.

- The strategy does not specify adequate audit coverage in terms of the number of leases, months, and years to be reviewed.

- The strategy does not address adequate lease coverage of the $5.1 billion of royalties paid in 1982. Unless acted upon in 1988, the records for these royalties may no longer be available.

- The strategy does not provide a mechanism to track the results of audit coverage of the lease universe.

Question 5. Apparently last week, MMS finalized an "audit plan." Are you familiar with this audit plan?

o How does the "audit plan" differ from the "audit strategy?"
o Do you think the plan is adequate?
o Do you think that MMS is capable of implementing the plan?

Answer. We have reviewed the Minerals Management Service audit plan that was prepared by the Service in response to our audit report. The major differences between the audit plan and the audit strategy are as follows:

- The audit plan is for fiscal year 1988, while the audit strategy is long term through 1993.

- The audit plan supplements the audit strategy and identifies specific companies scheduled for audit.

- The audit plan provides background data, location of the audit, and prior audit coverage information for specific companies.

- The audit strategy provides an overall objective for the Service's auditors, while the audit plan identifies the specific companies to be audited and the resources to be assigned.

The audit plan is a significant improvement over previous Service annual audit plans. As part of our next biennial audit, we will test the effectiveness of the plan and the extent to which it is followed. We consider the new company audit approach used by the Service to be a better strategy than the lease audit method previously used.

In regard to the Service's capability, we were advised by management officials that they believed they had sufficient resources to accomplish all elements of the plan. The Service, however, has not completed a sufficient number of comprehensive company audits to develop reliable historical data on staffing needed to ensure a 6-year audit cycle. We will evaluate the effectiveness and implementation of the plan in the next biennial audit and make any needed recommendations for improving the audit plan and resource allocation.

Question 6. The Federal Oil and Gas Royalty Management Act requires, among other things, that the Secretary establish a "comprehensive" production accounting and auditing system. Generally, what additional steps do you think MMS needs to take to successfully carry out this mandate?

Answer. Minerals Management Service implemented the automated Production Accounting System for all offshore lease operators and 14 onshore operators to meet the production accounting requirements of the Act. On June 29, 1987, the Department of the Interior decided to develop an automated system for onshore leases. However, our April 1988 report on the Service's Production Accounting Division concluded that full implementation of the automated onshore system may not be cost-effective or efficient. We recommended that the Department limit implementation of the automated onshore system to one location to determine whether full implementation of the system will provide the anticipated benefits.

To successfully carry out this mandate, the Service may want to consider manually comparing production records with sales records on some onshore and Indian leases. In addition, this information will be compared during audits of the leases.

Question 7. The Linowes Commission Report noted that the most commonly used figure in estimating underpayment of oil and gas royalties was 10 percent. Does your work lead you to think that underpayments are a problem?

- Do you think that 10 percent is a reasonable estimate?
- What should MMS be doing about underpayments?

Answer. Our previous audit reports indicated that underpayments are a problem. For example, our audits of 44 of the top 100 oil and gas companies and 10 gas plants reported potential net underpayments of $152.4 million. However, our prior audit work did not support an underpayment rate of 10 percent or any other figure

In our royalty audits we determined that companies are unique and that underpayment percentages varied for each company and time period. Moreover, our audits included only 44 of about 2,000 payors; thus the results are not representative of the payors that were not audited. Although our previous audits reported underpayment rates between 2 and 7 percent, we did not project these rates to the entire audit universe because such a projection would have been statistically invalid.

It is our opinion that Minerals Management Service should ensure that underpayments are identified promptly through audits and other techniques such as automated exception processing and the comparison of reported production and sales. Any underpayments identified should be promptly billed and collected, along with the appropriate interest and penalties.

Question 8. Your report indicates that MMS has not implemented adequate procedures to ensure that the disposition of $7.6 million in reported underpayments was effectively resolved. What procedures need to be implemented to take care of this problem?

Answer. This matter was discussed in our report covering the Fiscal Accounting Division. Reported royalty underpayments were not effectively resolved because of (1) inadequate data verification routines in the automated processing system and (2) the Divisional policy of resolving reported underpayments based on the dollar value of the royalty document rather than the amount of the royalty underpayment. Before the Division will initiate the reported underpayment resolution process, information in a payor-prepared royalty report must pass a data verification routine and be accepted into the Minerals Management Service's accounting system. We recommended that the Service (1) resolve reported underpayments regardless of whether or not the information has passed a verification routine and (2) resolve underpayments based on the potential collection amount. The Service is in the process of implementing our recommendations.

Question 9. FOGRMA requires that the Secretary reconcile, to the extent practicable, all current and past lease accounts. However, your report on Fiscal Accounting indicates that MMS has not devoted adequate resources to reconcile payor account balances.

o What is the magnitude of this problem?
o What should MMS do to remedy the situation?

Answer. As of December 31, 1986, 1,300 of the 2,000 active payor accounts were not reconciled, and reported underpayments (cash shortfalls) of a net $16.8 million were included in the unreconciled accounts. A cash overage (overpayment) or cash shortage (underpayment) exists when Minerals Management Service receives a payment that is more or less than the corresponding royalty reported. Our Fiscal Accounting Division report recommended that the Service dedicate the resources needed to reconcile account balances on a permanent and continuing basis. The Service agreed and, in October 1987, assigned seven additional people to reconcile payor accounts.

Question 10. You have testified about a 1986 audit report regarding the BLM's Inspection and Enforcement Program. The report contains what I consider to be very serious criticisms of that program. You conclude that fewer inspections are performed than should be, BLM cannot provide adequate assurance that inaccurate reporting of production and sales is not occurring, and the BLM cannot ensure that oil is not being improperly removed from Federal and Indian leases.

- Is this still the case?
- What kind of functions were the BLM inspectors performing?
- Do you think that we can now rule out the possibility that theft is occurring on Federal and Indian leases?

Answer. The situation described in the audit report may have improved. Bureau of Land Management officials informed us that their revised inspection and enforcement strategy document addresses inspection frequency and production verification. The document should be completed within one month. Our audit report noted that inspectors spent more time on clerical duties than on inspections and, in some cases, were assigned to work on noninspection program duties. Because of remote locations, isolated theft from Federal and Indian leases cannot be ruled out. However, new procedures on lease and oil transport inspections and improved training should reduce theft possibilities.

Question 11. Another area of concern to me involves the distribution of mineral receipts to the States, tribes, and Indian allottees. In your report on fiscal accounting, you state that MMS did not disburse about $3.1 million in royalties in a timely manner or to the proper recipient. Why is this the case?

- o Do you have an estimate of the magnitude of the problem?
- o What should MMS do to ensure that royalties are disbursed in a timely manner?
- o What should MMS do to ensure that royalties are paid to the proper recipient?

Answer. This condition occurred because (1) the Fiscal Accounting Division requires the receipt of royalty reports before disbursing payments on bills for collection, (2) there are software design deficiencies in the accounting system, and (3) the Division disburses the state's share of royalty payments before the Federal share.

These problems ($3.1 million noted during fiscal year 1986) are relatively minor when compared with the approximately $4.2 billion of royalty, rent, and bonus collections during fiscal year 1986. To ensure timely royalty distributions, we recommended that Minerals Management Service implement new procedures concerning payments on bills for collection and modify accounting system software. The Service agreed and indicated it implemented new procedures and was analyzing the feasibility of system software modifications.

Question 12. Your November 1986 report on BLM's drainage protection program concluded that BLM has not adequately supported the drainage protection program, and this lack of support could result in the loss of millions of dollars to the Federal government and Indians.

- o Is BLM adequately supporting the program currently?
- o What has been the royalty revenue against impact to the Federal government, States, and Indians from lack of an adequate program?

Answer. Bureau of Land Management program support now appears to be adequate, as evidenced by a reported (1) increase in funding and staffing at more than twice the level noted during our audit period, (2) increase in technical and clerical support, and (3) reduction in case backlog from 8,434 potential cases to about 4,578 cases.

In regard to an overall royalty revenue impact, our audit was not designed to compute such a figure, since this would have involved substantial additional audit resources. In addition, such a projection would be of questionable validity because each case is unique and numerous assumptions would have to be made, since specific data would not be available.

United States Department of the Interior
TAKE PRIDE IN AMERICA
MINERALS MANAGEMENT SERVICE
WASHINGTON, DC 20240

June 7, 1988

Honorable John Melcher
Chairman, Subcommittee on Mineral
  Resources Development and Production
Committee on Energy and Natural Resources
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

In response to your May 24, 1988, letter, I have enclosed our answers to questions resulting from the May 23, 1988, Subcommittee on Mineral Resources Development and Production oversight hearing. The questions refer to the Department of the Interior's Royalty Management Program.

Sincerely,

Wm D Bettenberg
Director

Enclosure

ADDITIONAL QUESTIONS FOR THE RECORD
FOR MMS
FROM ROYALTY MANAGEMENT HEARING
SUBMITTED BY SENATOR MELCHER
MAY 23, 1988

1. Question: Professor David Linowes, who chaired the Commission on Fiscal Accountability of the Nation's Energy Resources, reviewed the IG's audit reports, and reported to me that although there has been some action in implementing the Commission's recommendations, "progress seems to have been quite slow."

- It has been over 6 years since those recommendations were made, and all of the recommendations were accepted by the Administration. Yet by your own information, 11 of the recommendations have not been implemented. Why hasn't MMS been able to move more quickly to implement all of the Commission's recommendations?

Answer: While the Minerals Management Service (MMS) has been successful in implementing most of the Linowes recommendations, 11 of these 60 recommendations have proven infeasible or difficult to complete.

- Implementing a lease subaccount system (the Auditing and Financial System (AFS)), has actually been completed for all payors except one, El Paso Natural Gas Company. Though only accounting for about 1 percent of royalties, El Paso pays royalties for approximately 500 individuals and companies and could not be handled by our then existing computer capacity; hence, El Paso's conversion was deferred. The AFS was reimplemented on a new mainframe computer in late 1987. El Paso is currently being phased onto AFS with completion of this massive effort scheduled for January 1990.

- Implementing an operator of record for each lease and where possible a single payor has proven inappropriate. This approach was proposed in a *Federal Register* notice. Comments received from industry were negative, and legal questions regarding anti-trust violations and liability when paying for others were raised. The House Interior Committee also issued a report in 1984 opposing a single payor concept. After substantial review the Department decided not to proceed with the concept.

- As with the lease subaccount system implementation, the comparison of royalty and production data for all leases is well underway with over 80 percent of royalties currently covered by the Production Accounting and Auditing System (PAAS). This comparison is routine for all offshore and solid minerals leases, and has generated about $20.8 million in additional collections. Following concerns emanating from industry and other interested parties, including the 1984 report from the House Interior Committee, that extending PAAS reporting (the basis for the automated comparison) to onshore operations would be onerous, a comprehensive study of its costs and benefits was performed. The Department determined that PAAS, using modified forms, would be phased in for onshore operations. This phased conversion is scheduled to be completed by May 1989.

° Issuing detailed product value guidance to industry by July 1, 1983, was not attainable and, in fact, was actually illegal after Congress enacted a moratorium on product value regulations last year. Nonetheless, this major undertaking is nearing completion. Final regulations for oil and gas valuation were issued in January 1988 and were effective March 1, 1988. Final coal valuation regulations are planned to be issued by late 1988. Because of the far reaching impact of these regulations, MMS's proposed regulations were subjected to extensive review by all affected parties. Almost continuously since 1982, proposed regulations have been provided for public review, discussed in hearings, and published in the Federal Register. Following a review by the Royalty Management Advisory Committee (RMAC) in 1986, MMS proceeded to issue final oil and gas regulations; however, Congress included a provision in the Fiscal Year (FY) 1987 supplemental appropriation that prohibited implementation of the regulations before November 1987. Meetings were held with all concerned parties including congressional staff and led to final rulemaking in January 1988.

In January 1987, a notice of proposed rulemaking for coal valuation was published. Information received merited further comment periods. The MMS is evaluating the comments received and discussing them with principal affected groups. Further meetings with industry, States, and tribes will be conducted prior to the scheduled July publication of proposed final rules. Final rules are scheduled for publication in December 1988.

° We have twice recommended that Congress change the time-consuming process for offshore refunds. In 1982, such a proposal was included in the Administration's proposed legislation regarding oil and gas royalty management, but was not included when the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA) finally passed the Congress. In 1987, the Administration transmitted to Congress proposed amendments to FOGRMA which included a provision to repeal Section 10(b) of the Outer Continental Shelf (OCS) Lands Act of 1953 which establishes the 30-day review period for such refunds.

° Permitting a 60-day payment for gas was found infeasible after analysis revealed that the cost to the Government, States, and tribes would be prohibitive due to lost revenue which would result from the addition of 30 days to the payment cycle. However, gas royalty payors have the option of maintaining an escrow equal to 2 months average royalty payments which, in effect, allows a 60-day payment cycle.

° Seeking Federal legislation to prohibit purchases of undocumented crude oil and requiring purchasers to keep detailed documentation on their purchases was determined to be infeasible. Since the vast majority of crude oil produced in the United States is from non-Federal, non-Indian leases, recordkeeping by industry would have been far too burdensome. This function will be accomplished as part of the audit process.

- Seeking legislation to establish a self-sustaining fund from a percentage of royalties to pay for audits and inspections and other royalty collection and mineral leasing functions has been repeatedly attempted through the budget and appropriations process, but Congress has rejected this proposal each time it was proposed.

- Implementing PAAS immediately was not feasible as explained above. However, all offshore and solid minerals leases were implemented in 1985; and onshore leases are scheduled to be implemented over the course of the next year.

- Revising regulations or seeking legislative change to relieve MMS of its responsibility for calculating and paying Windfall Profit Tax (WPT) on royalty-in-kind transactions was determined to be inappropriate. The key reason for not shifting the burden to industry is that the Internal Revenue Service (IRS) opposed the concept, and it is their regulations that govern the issue.

- Using a minimum royalty rate of 16-2/3 percent on new or renegotiated leases is not being pursued. It seems particularly inappropriate considering what has happened to oil, gas, and coal prices since 1982.

2. Question: FOGRMA requires that current and past lease accounts be audited and reconciled. The Inspector General's report indicates that MMS has not devoted adequate resources to reconcile payor account balances.

- Why haven't more resources been devoted to this problem?

Answer: The FOGRMA reference cited in the question refers to the MMS audit program and to reconciliations of lease account balances from the old Royalty Accounting System (RAS) which existed before the AFS. This is not the same as the Auditing and Financial System (AFS) payor account reconciliations. It should be noted that the reconciliation effort required by FOGRMA was essentially completed in FY 1986.

In response to the question about payor account reconciliations, MMS has assigned additional resources to this effort. The MMS began identifying underpaid royalty reports in April 1986 using three employees, and in October 1986, assigned five contractor and two MMS employees to payor reconciliations. In April 1987, MMS determined that both overpayments and underpayments needed to be considered to fully reconcile payor account balances. The MMS conducted a study, wrote procedures, and began full payor account reconciliations in October 1987. The MMS currently has five contractor and four MMS employees assigned to payor account reconciliations and plans to complete the reconciliations by July 1989. As of May 1988, approximately 1,000 accounts remained to be reconciled. Work to date has revealed that only about $142,000 of $5.6 million reported underpayments reviewed proved to be valid. In contrast, over $275,000 in overpayments have been verified.

3. Question: I understand that there are some recommendations made by the IG that you do not plan to implement. Please describe these and explain why you will not implement them.

Answer: The MMS believes that implementing three of the Inspector General (IG) recommendations shown in its "Mission Accomplishment" reports would be inappropriate.

- In its report "Mission Accomplishment, Production Accounting Division, Royalty Management Program, Minerals Management Service," April 1988, the IG recommended that the implementation of the onshore PAAS be limited to one location to determine whether full implementation will provide the anticipated benefits at an acceptable cost. (It should be noted that the IG position is inconsistent with the Linowes Commission Report recommendation identified under Question 1.) The Department agreed with the spirit of the recommendation, but believes that such a limited implementation could not be used statistically to project the benefits to other districts. Instead, a phased-in approach is planned for PAAS as explained in the response to Question 1. This approach (comprising close to 50 percent of the lease universe) will provide a valid sample for analyzing the annual costs and benefits. The MMS will perform an analysis of the annual benefits and costs of the onshore system by March 31, 1990, based on reports received in January, February, and March 1989.

- In its report entitled "Mission Accomplishment, Fiscal Accounting Division, Royalty Management Program, Minerals Management Service," April 1988, the IG recommended among other things that 8(g) leases be reported and paid separately; and each State's share of 8(g) royalties be immediately deposited into interest-bearing Treasury securities. The MMS disagrees with the 8(g) recommendation. The Conference Report printed in the Congressional Record December 19, 1985, indicated that the Committees did not expect payors to segregate reports and payments for 8(g) portions of leases (the 8(g) zone usually covers portions of leases, rather than entire leases). It also acknowledged that the Department's current practice of disbursing funds at the end of the month in which they have been processed, segregated, and deposited to separate accounts would carry out the intent of the statute. In conclusion, the Conference Report stated, "It is anticipated that the Department can meet the requirements of section 8(g) (2) as amended without substantial revision of the current OCS reporting system, reporting forms, or Treasury account."

- In the same report, the IG also recommended that $539,000 be assessed on warning errors (royalty reporting errors which do not prevent timely disbursement of royalties collected). The MMS does not agree with assessing liquidated damages on warning errors since such errors do not prevent revenue distribution, are exclusively used for research purposes, and do not generate corrections costs. Based on 523,133 occurrences of the 8 cited warning error types in FY 1986, it would take an estimated 60 people to research and resolve those errors as they occur.

4. Question: The Linowes Commission Report noted that the most commonly used figure in estimating underpayment of oil and gas royalties was 10 percent. I take it that you believe the figure is much lower. Why should we accept your view?

° Do you think 2 or 3 percent is an acceptable level of underpayments?

Answer: The Linowes Commission Report (Report) recited various estimates of potential underpayments but provided no independent verification or analysis for any of them. The Report stated that the 10 percent underpayment figure is often used as a rough estimate of underpaid royalties and quoted a 1979 General Accounting Office (GAO) report which said audits conducted by a private oil and gas company show that "'. . . royalties due are normally understated by 7 to 10 percent.'" The Report further stated that the Department of the Interior IG ". . . suggested that a loss rate of 3-1/2 percent would probably be more accurate than 10 percent." On other occasions, the IG has presented underpayment figures of 6.9 percent and 2.5 percent of royalties paid on specific leases.

The MMS view is that an accurate estimate of underpayments can only be determined through audits of a very broad-based sample of leases, including those overpaid or properly paid. The GAO, the IG, and MMS do not consider such an effort to be a productive use of audit resources. The MMS believes its available audit time is better spent on areas likely to reveal underpayments.

The MMS has never indicated that initial underpayments do not exist. Just as with the IRS, it is not possible to collect all revenues "up front" when initial payments are based on voluntary compliance. However, it is MMS's goal to ensure that underpayments are ultimately collected and that interest is assessed for delay in payment. To accomplish this goal, MMS has established safeguards to detect underpayments, including 1) AFS exception processing which identifies certain royalty underpayments, late payments, and nonreporting; 2) the PAAS/AFS comparison which verifies agreement between production and sales reporting; and 3) the MMS audit program which ensures that a major portion of royalty revenues received are comprehensively audited.

5. Question: The IG report indicates that MMS has not implemented adequate procedures to ensure that the disposition of $7.6 million in reported underpayments was effectively resolved. What steps are you taking to remedy this situation?

Answer: The IG stated that MMS's procedure of resolving underpayments based on the dollar value of the royalty document rather than the amount of the underpayment was not an efficient use of resources and should be based on the potential underpayment amount.

The reason that MMS reconciles high dollar value documents first is that this procedure generates more revenue to be paid to Indians and States sooner than reconciling and clearing potentially underpaid royalty amounts. For example, when MMS cleared a $1.7 million royalty document that had a potentially underpaid amount of 1 cent, late payment interest income in the amount of $14,711, resulting from payor initiated royalty adjustments, was identified and billed through exception processing and appropriate shares could be paid to appropriate recipients much quicker. In contrast, a $2,622 royalty document that had a potentially underpaid royalty amount of $2,622 resulted in no additional royalties after reconciliation was completed.

The MMS's current effort to reconcile payor accounts will resolve both potential underpayments and overpayments. As stated earlier, this effort is scheduled to be completed by July 1989.

6. Question: An area of great importance to the States, Tribes and Indian allottees is the distribution of mineral receipts. The IG's report states that MMS did not disburse about $3.1 million in royalties in a timely manner or to the proper recipient. How did this happen and what are you doing so that this doesn't continue?

Answer: The $3.1 million in royalties referred to by the IG is comprised of approximately $2.0 million in collections for which the payor had not submitted a royalty document and $1.15 million in partial payments for billing adjustments. These amounts were not disbursed because the AFS did not allow 1) disbursement of royalties not accompanied by a royalty document and 2) disbursement of partially paid bills.

The MMS implemented procedures in February 1987 to ensure that collections resulting from audit bills are disbursed to the proper royalty recipient without awaiting royalty documents. Also, MMS is analyzing the feasibility of modifying the AFS to allow disbursement of partial payment of bills. This modification was identified by MMS's Systems Improvement Team and endorsed by the RMAC.

7. Question: Is MMS currently requiring royalty payment by a single payor on a production unit or under a communitization agreement?

- If not, why not?
- What are the advantages and disadvantages of this approach?
- Do you believe you have legal authority to do so?

Answer: The MMS does not require payment by a single payor on a unit or communitization agreement. The MMS has considered requiring a single payor on a lease and proposed rulemaking to that effect. However, there was considerable industry opposition and legal questions regarding this concept, and therefore the rulemaking was withdrawn. In addition, a December 1984 report by the House Committee on Interior and Insular Affairs recommended that MMS retain the multiple-payor concept on existing leases.

Like most controversial issues, there are pros and cons to implementing a single-payor policy. Proponents of a single payor argue that it would reduce the number of payors, thereby simplifying MMS's accounting processes as well as reducing the reporting burden on many small payors. Opponents maintain that the single-payor approach is inconsistent with industry practice and is not sensitive to anti-trust, proprietary, and liability concerns.

Under the single-payor concept, one designated payor would be responsible and legally liable for all other working interest owners operating on the leasehold. The designated payor may not have legal or contractual ability to force other interest owners to comply with the Secretary's requirements. The designated payor could thus be subjected to fines or penalties for another party over which he has no control. And the reverse is true; other interest owners would have no assurance that single payor noncompliance would not result in their liability or possible loss of the lease for nonpayment of royalties. Also, the single-payor concept would be difficult to implement where Federal leases include several individual producing properties having no common ownership, each having a different operator.

When we discussed a single-payor policy with the Solicitor and other jurisdictional agencies that would have an interest in ancillary legal issues (primarily the Department of Justice and the Federal Trade Commission), a number of concerns were raised. The most significant of these revolve around the anti-trust aspects, as the single-payor concept would require firms to disclose sales and pricing information to their competitors which is prohibited by anti-trust statutes.

Because of these limitations and the disadvantages listed above, we have not pursued this matter further.

8. Question: What is the Interagency Data Verification System?

- How is it used?
- How often are cross-checks made?

Answer: The Interagency Database Verification System (IDVS), assures that AFS and Bonus and Rental Accounting Support System (BRASS) reference data necessary for collection and distribution of bonuses, rents, and royalties for Federal onshore leases is consistent with data maintained by the Bureau of Land Management's (BLM) Case Recordation System. The IDVS is used to detect missing and nonmatching leases among MMS's AFS and BRASS and BLM's Case Recordation System. Cross checks/comparisons are made quarterly.

9. Question: Please describe the automated system for verifying all OCS oil production, referred to in your testimony.

Answer: The Liquid Verification System (LVS) is an integrated system of manual and automated processes for the verification of liquid hydrocarbon sales, royalty volume, and gravity reporting. This system is currently under development and is planned for implementation in September 1988. The LVS will use metered sales volume reports and other meter information submitted by facility operators and compare this information to PAAS reported disposition volumes.

The LVS is a logical extension of the existing Outer Continental Shelf Information System (OCSIS), currently used by Offshore Minerals Management (OMM), and PAAS, used by the Royalty Management Program (RMP). The OCSIS system will provide the reference data (facility, meter, proving reports, tank tables and run tickets) needed by the LVS process, and PAAS will provide the reported sales disposition volumes. By adding the LVS enhancements to OCSIS the two systems can complement each other and provide better accountability of liquid hydrocarbon quantity and quality.

The LVS will allow MMS to accurately determine the volumes passing through the sales and royalty measurement facilities. It will identify any discrepancies in reporting to OMM and RMP, therefore allowing reporting problems to be resolved efficiently. Also, the system will assure the validity of PAAS data.

The differences and discrepancies identified by the system will provide a basis for oversight of OMM and RMP at the facility measurement point. These discrepancies and resulting research and followup will serve as a source of data for correcting reporting discrepancies and for selecting possible audit candidates.

10. Question: Please describe the dispute referred to in your testimony for which nearly $20.5 million in civil penalties have been assessed. Who is the appellant in that matter?

Answer: In January 1983, MMS issued the first of several orders to Marathon Oil Company to use a different basis for establishing royalty value for gas produced for the Kenai Field in Alaska. When Marathon refused to comply, MMS warned the company that continued noncompliance would result in a "knowing and willful" violation under the provisions of FOGRMA, with a consequent penalty as high as $10,000 per day per violation. The violation was not corrected, and the maximum penalty of $10,000 per day for each of the seven leases was imposed as of July 13, 1984. The penalty period terminated as of April 30, 1985, when Marathon was ordered to comply with MMS's order by a U.S. District Court.

The penalty was later upheld by the Administrative Law Judge who reviewed the case. Marathon has appealed the penalty to the Interior Board of Land Appeals, but no decision has yet been issued.

IN REPLY REFER TO
1750(140)

United States Department of the Interior
BUREAU OF LAND MANAGEMENT
WASHINGTON, D.C. 20240

Honorable John Melcher
Chairman, Subcommittee on Mineral
  Resources Development and Production
Committee on Energy and Natural Resources
United States Senate
Washington, D.C. 20510-6150

Dear Mr. Chairman:

This is in response to your May 24, 1988, letter requesting additional information relating to the May 23, 1988, oversight hearing on the Department of the Interior's Royalty Management Program.

Enclosed are responses to your questions.

Your continued interest in the programs of the Bureau of Land Management is appreciated. If we can be of assistance, please let us know.

Sincerely,

Director

Enclosure

Q. 1. I understand that you are currently developing a strategy for your Inspection and Enforcement Program. Why wasn't this done long ago?

A. Strategy for the inspection and enforcement (I&E) program was first developed in 1982, right before the MMS/BLM merger. In response to the strategy, each State office prepares an annual inspection plan for the coming fiscal year. Through experience, the I & E strategy evolved over the past few years. First, the standards for establishing priority inspection items were modified; then the strategy was updated twice with respect to FOGRMA regulations; and finally the strategy for FY 1987 and 1988 restructures the production verification as a result of a pilot study and recommendations of the Bureau's Inspection and Enforcement Program Review Task Force. The most recent version of the strategy will be put in the Bureau manual as permanent instructions.

Q. 2. The Linowes Commission recommended that inspectors check trucks transporting oil off lease sites as a means of preventing oil theft. How many such inspections occurred last year?

A. There were no on-or off-lease inspections of oil transporters in 1987. Instructional Memorandum No. 88-231, "Guidelines for Inspection of Oil Transporters by Oil and Gas Inspectors" was issued February 8, 1988.

Q. 3. Are you confident that oil theft is not now occurring from Federal and Indian leases?

A. It is impossible to say with 100% certainty that oil thefts are not occurring on Federal and Indian leases. The BLM has instituted practices that minimize the opportunity for theft of oil from Federal and Indian leases.

Q. 4. The IG's report of June 1986 on BLM's Inspection and Enforcement Program identified 8 weaknesses in BLM's program. It stated that:

- o BLM management has not adequately supported the program and the program does not meet the principal objective of FOGRMA;
- o far too few inspections are performed;
- o BLM cannot provide assurance that accurate reporting of production and/or sales is occurring;
- o BLM cannot ensure that oil theft is not occurring from federal and Indian lease sites.

I have serious problems with the lack of support BLM management has shown toward this program.

A. Since 1982 the Bureau has stepped up the effort to strengthen the I&E program. The number of inspectors was increased from 60 in 1983 to 117 in 1987. The Bureau has issued many instructions and much guidance for I&E and provided a comprehensive training program for inspectors. There are 128 certified inspectors. At the current staffing level, we are able to meet the objective of inspecting, at least annually, all leases with significant production and/or a history of operator non-compliance. The following briefly addresses the 8 weaknesses identified in the report:

(1) State offices did not increase the number of I&E inspectors as prescribed by headquarters. Furthermore, inspectors were used for non-I&E programs.

State offices have increased the number of I&E inspectors as previously stated. The State Directors are responsible and accountable for accomplishing program objectives as established by the Director. They are expected to use the resources under their control to accomplish those objectives. Inspectors are not used for non-I&E work.

(2) Industry reports of oil and gas production and sales were not independently verified.

A pilot test study was performed during FY 1986 to independently verify the production reported by industry. The number of production verification inspections conducted is shown in response to Question No. 8. The result of the pilot study concluded that these time-consuming labor-intensive inspections, though appropriate in some cases, should be used only to investigate a perceived anomaly revealed from a less costly inspection approach. The pilot program revealed only a few instances where variances in measurement or reporting resulted in loss of product or royalty. However, in each case a regular production inspection would have surfaced the anomaly with much less inspector's time expended. Therefore, the current I&E strategy incorporates the production verification inspection as a Level Three inspection triggered by regular production inspections.

(3) Motor vehicles transporting oil from public lands were not inspected.

Guidelines for inspections of oil transporters by inspectors were issued February 8, 1988, to field offices and are being implemented.

(4) Guidance to field offices on interpretation of regulations was not provided in a timely manner.

(5) Oil and gas regulations have not always been implemented in a timely manner or consistently enforced.

BLM will conduct a program evaluation of Inspection and Enforcement this year to determine the extent of uniform and consistent application of regulations and instructions. In addition we are providing training courses to alleviate the non-uniformity issue. Regulations which implement FOGRMA were first published in 1984 and further revised and republished in 1987. Several onshore oil and gas Orders are being established and will further enhance BLM's effort to bring greater uniformity to the I&E program.

(6) Internal program reviews have not been effective in monitoring program administration at the field level.

The Quality Assistance Team effort identified certain program inconsistencies which were corrected as found. This internal program review function is now divided into two portions. The program evaluation is the responsibility of the Division of Program Evaluation at BLM headquarters; technical assistance and State oversight are the responsibility of each State Director. A program evaluation for I&E will be conducted this year. Instructions delegating the oversight function to the State have been issued.

(7) Cooperative agreements have not been entered into with states and Indian tribes.

The Bureau of Land Management has one cooperative agreement for oil and gas inspection and enforcement activities with the Ute Mountain Ute Indian Tribe of Colorado. This agreement is funded at $25,000 for FY 88.

The Bureau has two tripartite agreements among BLM, BIA and the Navajo and the Jicarilla-Apache Indian Tribes in New Mexico. These agreements are not funded by BLM. There are also two MOU's for oil and gas inspections between BLM and the States of Oregon and Nevada.

The Bureau is currently negotiating agreements with the Southern Ute Tribe in Colorado, the Blackfeet Tribe in Montana, the Uinta-Ouray Tribe in Utah and is renegotiating an agreement with the Shoshone-Arapaho Tribe in Wyoming.

No State government has yet requested a delegation of Inspection authority under FOGRMA.

(8) An adequate training program for inspectors does not exist.

The BLM implemented its inspector certification program in FY 1987 to ensure that inspectors and their supervisors are qualified to review oilfield practices and the application of BLM oil and gas regulations.

The certification Training Program consists of four (4) phases:

1. An orientation program for new employees.
2. Formal in-house training in fluid minerals inspection and enforcement drilling and production operations. This includes the Production Course, which addresses the conduct of independent oil and gas volume verification, reconciliation, and site security inspections, and a drilling course.
3. On-the-job training program.
4. A "technical review" in which a candidate for certification demonstrates certain inspection-related skills and knowledge.

Since 1984, 313 persons have attended Bureau-run drilling and/or production inspection training courses.

Q. 5. At the time of the IG's report on drainage, there was a backlog of 53 staff years. You say this has been improved. How were these cases resolved?

A. The number, 8,400 cases translating to 53 staff years, reported in the November 1986 IG report concerning drainage backlog was an estimate of potential drainage situations that could have existed. The estimated potential drainage situations as reported by the BLM field offices, are down to 4,578. Resolution and, thus, the reduction in number of potential drainage cases were accomplished through administrative and/or technical review of potential drainage situations which resulted in dismissing cases (no economic or physical drainage), drilling of a protective well to prevent drainage, entering into compensatory royalty agreement, or assessment of compensatory royalty for economic loss due to drainage.

Q. 6. According to the 1986 IG report on BLM's drainage program, in July 1984 the Bureau had identified the need to provide more resources to drainage protection, but as of November 1986, had failed to take necessary action. Problems identified in the report include BLM's failure to give drainage protection work a high priority, resulting in some instances of offices performing little or no drainage protection work; and inadequate technical drainage case analyses due to lack of expertise in drainage personnel.

- Why has the Bureau failed to adequately support this program?
- What steps has BLM taken since 1986 to improve this program?
- What are the royalty revenue implications of the failure of BLM to adequately protect federal lands from drainage?

A. Since the 1986 IG report, the Bureau has issued instruction memoranda to field offices to increase the priority of and support for the drainage program. This is demonstrated by comparing the funding and staffing in FY 1985 (funding $522,000, staffing 17) to FY 1987 (funding $1,314,000, staffing 35).

A number of steps were taken to improve the drainage program. Some of the steps taken were:

1. Increased priority, funding and staffing in support of the drainage program.
2. Conducted Internal Control Review of the program (OMB Circular A-123).
3. Formed task forces to review the program and make recommendations for improvement.
4. Established tracking system to monitor the program through automation.
5. Reviewed, revised, and/or updated the existing drainage Manual/Handbook to provide clear and detailed instructions in resolving potential drainage situations.

In the past few years the Bureau has taken a number of steps to improve the effectiveness of the drainage program. The royalty revenue implications, however, cannot be quantified since such revenue is greatly influenced by the prevailing economic conditions as well as the lengthy process that a drainage case has to go through from initiation to resolution.

Q. 7. You state in your testimony that leases requiring product verification through actual measurement can be identified through a regular production inspection process. Please explain.

- What are the steps in this "regular production inspection process?"
- Wouldn't a check on actual measurement always be more accurate?

A. Production verification through actual measurement is the most accurate method to determine the volume produced or sold. We are not implying that there is a substitute for actual measurement when determination of volume is required. However, we have concluded that through our regular production inspection we can identify cases requiring a production verification inspection. A regular production inspection consists of a routine inspection which is conducted, in part, to verify that the production is being handled, stored and measured in a manner that ensures a correct accounting thereof, i.e. compliance with the minimum site security requirement and checking to determine that all meters are functioning properly. Inspectors also routinely witness the proving and calibration of meters to ensure their accuracy. Any anomalies found as a result of either of the foregoing regular (now Level One) inspections will then trigger the following actions (Level Two or Three). Level Three inspections require actual measurements.

Q. 8. How are level three inspection triggered?

- How many of these inspections were conducted during FY 1986, 1987 and 1988 to date?
- How many level one and level two inspections were conducted during these years.

A. Our answer to the previous question explains how higher level production verification inspections (PVI) are triggered as a result of a Level One (regular) production inspection.

Level Two inspections are exception resolution inspections and are performed in response to problems (flags) identified in Level One inspections. Such inspections may also be initiated in response to problems (flags) identified by some other source, such as MMS or BIA. Level Two inspections consist of whatever action is required to resolve a specific flag (short of a complete PVI). A Level Two inspection may occasionally be an action taken which does not require a trip to the field, e.g., the verifying of run tickets for a specific period. If it is determined a complete PVI is required, the Bureau proceeds to a Level Three production verification inspection.

The Level Three PVI is a very detailed production and sales verification inspection. This type of very labor intensive inspection is designed primarily for cases where there is reason to suspect significant loss due to mishandling of oil or gas production.

The number of production verification inspections (Level Three) and regular (Level One) production inspections is presented for the five major oil and gas producing States as follows. We do not have information on Level Two inspections.

Number of Production Verification Inspections (Level Three)

State	FY 86	FY 87	FY 88 (to date)
CO*	125	165	0
MT	30	69	23
NM	81	56	6
UT	9	19	3
WY	76	75	0

* For reporting purposes, Colorado used a broader definitions for a PVI in FY 1987 which resulted in higher figures relative to the other States.

Number of Producing Lease Items Inspected (Level One)

State	FY 86	FY 87	FY 88 (as of 3/88)
CO	1256	945	604
MT	1454	1262	654
NM	8202	5467	456
UT	1208	903	370
WY	2457	1525	654

Q. 9. When will proposed regulations for cooperative agreements under Section 202 be published?

A. Proposed regulations for Section 202 Cooperative Agreements with States and Tribes have been prepared and are currently being circulated within the Department for review. It is anticipated that they will be published as a proposed rulemaking in the Federal Register by October 1988.

Q. 10. Specifically, what is the status of implementation of each recommendation made by the Office of Inspector General in the audit reports entitled "Review of the Bureau of Land Management Inspection and Enforcement Program" (June 1986) and "Drainage Protection Program Bureau of Land Management " November 1986)? Please describe fully.

A. Inspection and Enforcement Program

Recommendation 1-1. Direct BLM offices to increase the number of I&E inspectors to authorized levels.

Implementation Status.

The State Directors are advised each year of the Bureau's priority programs and provided guidance and resources to maintain all programs and accomplish priority objectives. As a result, State Directors have increased their emphasis on the I&E program and strive to accomplish Bureau objectives by using all resources under their control.

Recommendation 1-2.

Direct that field office management not assign I&E inspectors to work in non-I&E programs.

Implementation Status.

Inspectors are not used for non-I&E work.

Recommendation 1-3.

Provide clerical support to the I&E program.

Implementation Status.

State Directors have increased clerical support to the I&E program. This has been accomplished by hiring data entry personnel and assigning applications and records clerks directly to the I&E program. Results are that inspectors are spending about 70% of their time conducting inspections.

Recommendation 2-1.

Emphasize oil and gas production and sales volume verifications during inspections.

Implementation Status.

Oil and gas volume verifications, also known as production verification inspections, constitute only one of several important and significant tools in the arsenal of appropriate inspection methodologies. Our recent nationwide production verification pilot program convinces us that these time-consuming labor-intensive inspections, though appropriate in some cases, should be used only to monitor a perceived anomaly revealed from a less costly inspection approach. The pilot program revealed only a few instances where variances in measurement or reporting resulted in loss of product or royalty. However, in each case, a normal production accountability inspection would have surfaced the anomaly with much less Petroleum Engineering Technicans time expended.

Recommmendation 2-2.

Require inspectors to verify oil and gas volumes produced and sold by operators and compare them to volumes reported as produced and sold on the Monthly Report of Operations (form 3160-6). Such verifications should include meter readings and tank gaugings and reconciliations of sales volumes reported on Form 3160 to run tickets and gas charts. Any differences noted as a result of reconciliations should be resolved.

Implementation Status.

The Bureau has found that production verification inspections, in and of themselves, are not an effective tool. Instead, they are more appropriate if used selectively when specific anomalies so dictate. Therefore, the current I&E strategy incorporates the production verification inspection as a Level Three inspection triggered by regular production inspections.

Recommendation 2-3.

Provide training for a significant number of inspectors in all phases of independent oil and gas volume verifications and reconciliations and site security.

Implementation Status.

The Bureau has an ongoing training program which includes training inspectors on how to conduct independent oil and gas volume verifications and reconciliations and to conduct site security inspections. The inspectors Production Inspection Training Courses, Course Number 3000-18, is offered at least twice each year.

Recommendation 2-4.

Require inspectors to verify production and sales volumes of inspection items with monthly production of less than, 3,000 barrels of oil and/or 30 million cubic feet of gas, on a sample basis.

Implementation Status.

A pilot test study was performed during FY 1986 to independently verify production. The result of the pilot study concluded that these time-consuming labor intensive inspections, though appropriate in some cases should be used only to check out a perceived anomaly revealed from less costly inspection approach. The pilot program revealed only a few instances where variances in measurements or reporting resulted in loss product or royalty. However, in each case, a regular production inspection would have surfaced the anomaly with much less inspector's time expended. Therefore, the current I&E strategy incorporates the production verification inspection as Level Three inspections triggered regular production inspections.

Recommendation 2-5.

Inform the office of the agency that is responsible for reconciling sales volumes on the Monthly Report of Operations with sales volumes on the report of Sales and Royalty Remittance.

Implementation Status.

The Bureau is responsible for verifying that the amount of production reported by the operator is accurate. MMS is responsible also for determining that the proper royalties are paid on production. MMS also has been given the responsibility to compare reported sales and production data.

Recommendation 3-1. Develop and implement a program for inspecting oil transporters. If BLM is concerned with transporters physically harming inspectors, then oil transporters inspections should be performed with an I&E inspector and a criminal investigator from BLM.

Implementation Status

Guidance for inspections of oil transporters by inspectors was issued February 8, 1988, to field offices and is being implemented.

Recommendation 4-1. Uniformly interpret, enforce, and implement the Onshore Oil and Gas Operations regulations.

Implementation Status

When published, Onshore oil and gas orders will provide standards against which operators can be judged. These orders are in various stages of development.

Recommendation 4-2. Require that program evaluations performed by BLM's Quality Assistance Team specifically address uniformity in the interpretation, enforcement, and the implementation of oil and gas regulations as prescribed by FOGRMA.

Implementation Status

Quality Assistance is the responsibility of the State Directors, with oversight by the Washington Office Division of Program Evaluation.

Recommendation 4-3. Ensure that regulatory issues of importance to the field offices and industry, once identified, are expeditiously addressed and resolved.

Implementation Status

The Bureau holds internal meetings at National, State, and District levels and conducts regional industry meetings to identify and resolve regulatory issues.

Recommendation 5-1. Develop and implement an effective program for using CAs with Indian tribes, BIA, and States.

Implementation Status

The Bureau of Land Management has one cooperative agreement for oil and gas inspection and enforcement activities with the Ute Mountain Ute Indian Tribe of Colorado. This agreement is funded at $25,000 for FY 88.

The Bureau has two tripartite agreements between the BLM, BIA and the Navajo and the Jicarilla-Apache Indian Tribes in New Mexico. These arrangements are not funded by BLM. There are also two MOU's for oil and gas inspections between BLM and the States of Oregon and Nevada.

The Bureau is negotiating agreements with the Southern Ute Tribe in Colorado, the Blackfeet Tribe in Montana, the Uinta-Quray Tribe in Utah and is renegotiating an agreement with the Shoshone-Arapaho Tribe in Wyoming.

Recommendation 5-2.

Request funding to provide financial assistance to cooperators for costs (including training) incurred in performing inspections on behalf of BLM.

Implementation Status.

The Bureau provides financial assistance as negotiated under the agreement. Funding is obtained through the Bureau's normal budget process.

Recommendation 5-3.

Consider the inspection priorities of interested cooperators when entering into CAs.

Implementation Status

Inspection priorities are determined at the local Bureau office. These offices coordinate with all surface management agencies to determine the appropriate inspection priority.

Recommendation 6-1.

Develop certification standards that will ensure a uniform level of competence for I&E inspectors.

Implementation Status.

The BLM implemented its inspector certification program in FY 1987 to ensure that inspectors and their supervisors are qualified to review oilfield practices and the application of BLM oil and gas regulations.

The Certification Training Program consists of four (4) phases:

1. An orientation program for new employees.
2. Formal in-house training in fluid minerals inspection and enforcement drilling and production operations. This includes the Production Course, which addresses the conduct of independent oil and gas volume verification, reconciliation, and site security inspections, and a Drilling Course.
3. On-the-job training program.
4. A "technical review" in which a candidate for certification demonstrates certain inspection-related skills and knowledge.

Since 1984, 313 persons have attended Bureau-run drilling and/or production inspection training courses.

Drainage Protection Program

There were a total of 12 recommendations made by the IG report. The status of implementation of each recommendation is as follows:

Recommendation 1-1. Increase the priority of the drainage protection program. Also, sufficient financial and personnel resources should be committed to drainage protection to eliminate the present backlog in a reasonable time.

Implementation Status BLM issued an instruction memorandum (IM 87-398 dated, April 10, 1987) increasing the priority of drainage protection starting in FY 1987. Increased funding and staffing are as shown below:

	FY 1985	FY 1987
Funding	$522,000	$1,314,000
Staffing	17	35

Reduced backlog from 8,434 potential cases to about 4,578 cases as of end of FY 1987.

Recommendation 1-2. Consider using technicians or clerks to assist geologists and petroleum engineers in performing drainage protection reviews.

Implementation Status Use of technicians and clerks to assist geologists and petroleum engineers was begun in early 1987.

Recommendation 1-3. Issue a memorandum immediately to clarify Instruction Memorandum No. 85-289.

Implementation Status. Instructions to clarify IM 85-289 are provided in the revised Manual/Handbook to be issued in November 1988.

Recommendation 2-1. Provide drainage protection technical training. This training should include geologic mapping of reservoir, reservoir engineering techniques, and economic analyses of potential protective wells.

Implementation Status. BLM established a work group to evaluate training needs. The work group submitted its final report and recommendation in April 1988. The Bureau will consider establishing a training program.

Recommendation 2-2. Provide detailed drainage protection guidance including:

a. A definition of when drainage occurs.

b. Detailed procedures for geologic analyses, engineering methods to estimate drained hydrocarbons, and economic analyses.

c. Criteria for determining when the "fraudulent drainage" situation applies and how to handle these cases.

d. Documentation requirements to support technical analyses and drainage determinations.

Implementation Status. The Bureau issued IM 86-702 (dated September 11, 1986) which transmitted the "Final Report on the Development of Standards and Procedures for the Oil and Gas Drainage Identification and Determination Segments of the Reservoir Management" to its State offices.

Recommendation 2-3. Establish a system of formal peer and supervisory reviews of technical drainage case work.

Implementation Status. IM 86-702 provides instructions for establishing a system of formal peer and supervisory reviews of technical drainage case.

Recommendation 2-4. Establish a program for periodic external reviews of drainage programs.

Implementation Status. The Bureau established a system of Alternative Internal Control Review based on OMB Circular A-123 to monitor the drainage program. The first review of this type was completed in October 1987.

Recommendation 2-5. Direct the Albuquerque, Rawlings, and Rock Springs District Offices to pursue the seven cases involving common ownership in the offended leases and the offending wells.

Implementation Status. The Bureau instructed the respective offices to further examine the seven cases. The drainage case in Rawlins District Office (DO) was resolved and no compensatory royalty was assessed. Two drainage cases in the Rock Springs District Office are under review to resolve the drainage situation. Of the four cases in the Albuquerque District Office, one case (428) has been resolved and the other three cases are expected to be resolved in the near future.

Recommendation 3-1. Direct offices that perform drainage work to issue notices of potential drainage when potential drainage is first identified.

Implementation Status. IM 86-702 provides instructions to issue notices of potential drainage. Revised Manual/Handbook, to be issued soon, will also provide guidelines for issuing notices of potential drainage.

Recommendation 3-2. Require offices that perform drainage work to refer parcels of unleased land subject to potential drainage to state offices when identified. State offices should process unleased land in a timely manner.

Implementation Status. IM 86-702 provides instructions to refer parcels of unleased land to appropriate State office for leasing. Similar guidelines will be provided in the upcoming revised Manual/Handbook.

Recommendation 3-3. Develop and implement a detailed drainage case tracking system for use by the field offices.

Implementation Status. IM 86-702 and revised Manual/Handbook both provide instructions to establish tracking systems.

Recommendation 3-4. Coordinate the development and acquisitions of all computer program for use by the drainage protection program.

Implementation Status. The Bureau is making considerable progress on ongoing Bureauwide projects that will provide automation in most oil and gas operations. A task force is currently being formed to address the automation needs of the drainage protection program.

Q. 11. Specifically, what are the financial and personnel resources committed to drainage work currently? Please provide these statistics in terms of dollars and staff years and percentage of total dollars obligated for the fiscal year and percentage of staff years for fluid minerals operations. How many full time equivalents are assigned to drainage work nationwide?

A. As of April 30, 1988, the Bureau has expended a total of $708,133 and 213 work months on the drainage program in FY 1988. This amounts to 2.8 percent of total program expenditures ($25,007,883) and 2.75 percent of total work months (7,733) for FY 1988. The Bureau does not assign specific numbers of FTE to the drainage program. Employees will work on drainage and other program components.

Q. 12. The IG's report found that only 22 percent of I&E inspector's time was spent in "direct inspection hours". What percentage of time is spent in "direct inspection hours"?

13. What percentage of inspectors' time is spent on clerical and administrative duties under the I&E program?

A. Inspectors spend a part of their time doing administrative tasks that are related to the inspection and enforcement activity. This includes verifying ownership, lease and well locations, determining appropriate approvals of operations, reviewing reported production levels and documenting inspection results. The Bureau has removed much of the need for inspectors to spend a great deal of time performing these tasks by providing much of this information through the Automated Inspection Records System. Further, field offices have set goals to have inspectors in the field 80% of the time.

BLM does not maintain a system that tracks how much time inspectors spend at each phase of their job. However, our field inspection and enforcement leaders estimate that inspectors spend about 70% of their time conducting inspections. This time includes travel to inspection locations.

Q. 14. Does BLM currently reconcile verified production and sales to monthly production and sales reports received?

- Is this information provided to MMS?

A. No. MMS's Production Accounting and Auditing System (PAAS) compares production to sales. By May 1989 all oil and gas leases will be in PAAS.

Q. 15. What are the financial and personnel resources committed to the I&E program currently? Please provide these statistics in terms of dollars and staff years and percentage of total dollars obligated for the fiscal year and percentage of staff years for fluid mineral operations.

- How many full time equivalents are assigned to the I&E Program nationwide? Please provide the number of FTE's assigned to do each inspection, administrative and clerical work.

A. As of April 30, 1988, the Bureau has expended $3,263,486 and 112 FTE on the inspection and enforcement activity. This amounts to 12.9% of total program activity expenditures ($25,007,883) and 14.5% of total program work months (7,733).

The Bureau does not assign a specific number of FTE to perform activities related to inspection and enforcement. Field offices assign work based on their needs. Currently, the Bureau has 117 inspectors.